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No. 14731

United States Court of Appeals
For the Ninth Circuit

AVALO ALLISON FISHER, *Appellant*,
v.
UNITED STATES OF AMERICA, *Appellee*.

APPEAL FROM A JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE WESTERN DISTRICT OF
WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

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United States Court of Appeals

For the Ninth Circuit

AVALO ALLISON FISHER,	<i>Appellant,</i>	} No. 14731
v.		
UNITED STATES OF AMERICA,	<i>Appellee.</i>	

APPEAL FROM A JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE WESTERN DISTRICT OF
WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a judgment of the United States District Court for the Western District of Washington, Northern Division, convicting appellant on the first four counts of a six-count indictment (A.1),¹ which charged violation of 18 United States Code, Section 1001. Jurisdiction below is based on Section 3231 of Title 18 of the United States Code. Appellant was acquitted on the fourth and fifth counts of the indictment. Jurisdiction of this Court is conferred by 28 United States Code, Sections 1291 and 1294.

¹“A” references are to the Appendix of appellant’s brief, and are followed by a number designating which item of the Appendix is referred to. “Tr.” references are to the Clerk’s original transcript. “R” references are to the Reporter’s transcript of proceedings and “X” references are to the Government Exhibits.

STATEMENT OF THE CASE

Section 9(h) of the Labor Management Relations Act, 1947, 61 Stat. 143, 146, 29 U.S.C. 159(h), commonly known as the Taft-Hartley Act, provides that a labor organization shall not have access to the processes of the National Labor Relations Board unless there is filed annually an affidavit by each of its officers "that he is not a member of the Communist Party or affiliated with such party, and that he does not believe in, and is not a member of or supports any organization that believes in or teaches, the overthrow of the United States Government by force or by any illegal or unconstitutional methods."

Appellant had been an executive board member of District 23, Local 93, International Woodworkers of America, formerly District 2, Local 93. On June 29, 1951, July 11, 1952, and June 5, 1953, appellant executed affidavits under the terms of the said Section 9(h) of the said Act (X. 1, R. 38; X's. 2, 3, R. 44, 45).

The indictment charged violation of the False Statements Act, 18 U.S.C. 1001, in six counts, alleging that two crimes had been committed in the signing of each of the three non-Communist affidavits. Specifically, this was done by alleging that each affidavit was false in two respects, in that at the time appellant executed each affidavit he was, in fact, a member of the Communist Party (Counts 1, 3 and 5), and simultaneously was "affiliated" with the Communist Party (Counts 2, 4 and 6) (A.1).

The jury acquitted appellant of the fifth and sixth

counts (Tr. 27), and he was sentenced to five years' imprisonment on each of the remaining four counts, the sentences to run concurrently (Tr. 34).

The indictment did not charge any falsity in the belief portion of the affidavits, or membership in an organization believing in or teaching the overthrow of the government by force or illegal methods.

The trial court denied all pre-trial motions made by appellant, including motions to dismiss the indictment (Tr. 3, 16), motion to require election of counts (Tr. 4); motion for discovery and inspection (Tr. 5), motion for bill of particulars (Tr. 6, 15). During the trial the District Court denied appellant's motions for production and admission of records showing the amount of money paid to the major government witness Harley Mores, by the Federal Bureau of Investigation (R. 333, 335, 336, 369, 370) and renewed motion for same (R. 749). The District Court denied appellant's motion to strike prejudicial and irrelevant testimony given by the witness Clark Harper (R. 410-412) and the District Court refused to permit appellant to show that government witness Clark Harper had testified falsely under oath in making identification of alleged Communists (R. 463-522). The District Court denied appellant's motion for judgment of acquittal made at the conclusion of the government's case (R. 647). The District Court refused to grant appellant to call United States Attorney Harris as a witness for the defense in order to prove prior inconsistent statements by the government witness Clark Harper and to prove that said wit-

ness did not have any direct knowledge of appellant's membership in the Communist Party (R. 692-699).

At the conclusion of the trial, the District Court denied appellant's motion for arrest of judgment (Tr. 29, 33) and motion for judgment of acquittal or, in the alternative, for a new trial (Tr. 28), based on the grounds previously alleged and upon the prejudicial error committed by the government in closing argument to the jury.

The instructions to the jury by the trial court will be discussed more fully in the body of the brief.

The Evidence In The Case

As we have already indicated by the reference to the denial of all motions for an amended bill of particulars and amended motion to dismiss and to compel election of counts (Tr. 15, 16, 4), the government never at any time throughout the trial made any clear-cut distinction between the terms "membership" and "affiliation." No witness attempted to define these terms nor did the government propose such distinctions by way of argument, and, as our argument on this point will show, no clear-cut distinction was made in the instructions given to the jury.

Apparently, it was the government's theory of the case to attempt to prove by "inference" (Tr. 13) that appellant was a member of and affiliated with, the Communist Party at the time he signed the three non-Communist affidavits (X's. 1, 2, 3), and that if the jury did not believe that the evidence was sufficient to con-

stitute membership, that it might nevertheless convict appellant under the counts alleging "affiliation."

The government presented nine witnesses, of whom four were technical witnesses:

(a) CASTLE (R. 14), the business agent of appellant's local union, testified that appellant had signed the affidavits and that the local union has had matters before the National Labor Relations Board since the filing of the first affidavit signed by appellant. While he was on the witness stand, he was also made a witness for the appellant, and testified as to appellant's good character and reputation in the community (R. 33, 34).

(b) SCHELDT (R. 36), a notary public, testified to witnessing the signing by appellant of Exhibit 1, in 1951. He also testified to the good character of the appellant (R. 40, 41).

(c) BOWDEN (R. 42), a notary public, testified to having witnessed the signing by appellant of Exhibits 2 and 3, in 1952 and 1953, respectively.

(d) GRAHAM (R. 46), Regional Director, Nineteenth Region, N.L.R.B., residing in Seattle, Washington, testified that the local had availed itself of the services of the N.L.R.B.

The first two non-technical witnesses for the government, ODLE (R. 73) and DURHAM (R. 77), police officers, testified to an incident allegedly taking place on June 6, 1930, one year prior to the signing of the first affidavit (R. 74-76) in which they saw appellant in possession of some "white pamphlets." Odle testified that

at the time appellant denied to him that he was a Communist (R. 76). The witness Durham (R. 77), in connection with this incident, confirmed the presence of "an unusual amount of white pamphlets." To show that this is a fair statement of the testimony, the full testimony relating to the incident is set forth in Appendix Item 2, p. 73).

Only three witnesses testified as to anything which could conceivably connect appellant to the Communist Party at any time. These were the witnesses Harley Mores, his wife Mazie Mores, and Clark Harper. The testimony of Harper as will later be argued, was immaterial and prejudicial, in that it had no relation to any of the items or events set forth in the indictment, and in other respects.

The testimony of Harley Mores (R. 89) constituted the sole testimony against the appellant, and consisted of testimony concerning meetings which the witness characterized as being meetings of members of the Communist Party, on two of which occasions appellant is alleged to have given the witness certain documents (X.'s 7, 8, 9) in a capacity of a member of the Communist Party. The testimony of this witness will be analyzed in argument *infra*, relating to the sufficiency of the evidence.

The witness Mazie Mores, wife of Harley Mores, agreed (R. 611), with the testimony of her husband only with reference to one conversation, two meetings dated December 26, 1952, and another meeting in May of 1953 (A. 611 *et seq.*).

Appellant, in his argument hereinafter, discusses the testimony of Harper, and Harley and Mazie Mores in considerable detail, in order to show that the verdict was not supported by the evidence and that, *a fortiori*, under the perjury rule, a judgment of acquittal was mandatory.

Appellant's argument will also discuss errors committed by the trial court preventing appellant from having a fair trial, in admitting irrelevant and incompetent evidence and in excluding the evidence offered by appellant, and in certain misconduct in the government's argument to the jury.

Appellant presented four witnesses in addition to the character testimony of the two government witnesses (Castle, R. 14), (Scheldt, R. 40, 41). These witnesses were his employer, Merle C. Hitchcock (R. 703), Frank Padavich, a fellow townsman in North Bend, Washington (R. 702), Frank Swanson, a fellow member of the Executive Board of appellant's union (R. 709), and his next-door neighbor, John G. Huber R. 729).

STATUTE INVOLVED

18 United States Code 1001 reads as follows:

“Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent

statement or entry, shall be fined not more than \$10,000 or imprisoned not more than five years, or both. (June 25, 1948, c.645, §1, 62 Stat. 749)."

STATEMENT OF POINTS

Appellant relies upon each and every one of the concise statements of points heretofore filed in this court and said statement of points is incorporated herein as follows:

1. The District Court erred in denying appellant's motion to dismiss the indictment (Tr. 3) and amended motion to dismiss the indictment (Tr. 16) upon the grounds that:

a. The indictment is based upon Section 9(h) of the Labor Management Relations Act of 1947, and said Act and indictment are unconstitutional, abridging rights guaranteed by the First Amendment, and said Section 9(h) is so vague and indefinite as to render it unconstitutional under the First and Fifth Amendments;

b. The indictment does not set forth with sufficient clearness, precision and certainty the time, place and manner in which the offense is alleged to have been committed, and is vague and indefinite to the extent that appellant was unable to prepare his defense, and there is a fatal inconsistency and contradiction between the charge alleged in Count I and the charge alleged in Count II, and the same is true with respect to Counts III and IV, and V and VI respectively;

c. The indictment does not state facts sufficient to constitute an offense against the United States, and the indictment is vague and indefinite and fails to in-

form the defendant adequately of the offense charged so as to enable him to make his defense;

d. The indictment alleges three offenses in six counts, to the prejudice of the appellant;

e. The indictment omits an essential element of the alleged offense, in that it fails to state that the alleged false statements and representations were material, or to state facts to show their materiality;

f. The second and fourth and sixth counts of the indictment are vague and indefinite in that they charge the appellant with alleged false statements, in that he denied that he was "affiliated" with the Communist Party, said word "affiliated" having no precise meaning and being vague, uncertain and indefinite in character, thereby providing no intelligible standard of conduct, and therefore failing to give appellant any fair or adequate notice of the offense charged;

g. The indictment fails to state overt acts to show when, where and in what manner, or by virtue of what facts, appellant was "affiliated" with the Communist Party at the time of the alleged offense ;

h. Section 1001 of Title 18, and Section 159(h) of Title 29, of the United States Code, under which the indictment is brought, and pursuant to which the alleged affidavits were allegedly executed and filed, are unconstitutional on their face, and as applied to the appellant, and, in particular, violate Article I, Section 9, Clause 3, and the First, Fifth, Ninth and Tenth Amendments to the United States Constitution, Section 1001 of Title 18, and Section 159(h) of Title 29

of the United States Code, pursuant to which the alleged false affidavits were allegedly executed and filed, and as applied to the appellant by the indictment, violate the foregoing and above stated provisions of the United States Constitution, in that the indictment does not state:

1. That appellant did or does believe in, teach or advocate political strikes;
2. That any organization of which appellant may be an officer acted or acts in such a manner as to be a burden on or obstruction to interstate commerce;
3. That there was or is a probability or danger that either appellant or any labor organization of which he may have been an officer has engaged or will engage in political strikes or any conduct or activity which has been or will be an obstruction to or burden on interstate commerce.

2. The District Court erred in denying appellant's motion to require election of counts, in which appellant requested an order requiring the appellee to elect between Counts I or II, III or IV, V or VI, respectively, of the indictment, on the ground that appellant would be prejudiced by the improper multiplicity of counts (Tr. 4).

3. The District Court erred in denying appellant's motion for discovery and inspection on the ground that such discovery and inspection was necessary to enable the appellant to prepare his defense (Tr. 5).

4. The District Court erred in denying appellant's motion for bill of particulars filed July 7, 1954 (Tr. 6),

and amended motion for bill of particulars filed September 30, 1954 (Tr. 15), on the ground and for the reason that a bill of particulars as requested by the appellant was necessary in order to enable him to prepare his defense, and which was further necessary to define the offense charged with sufficient certainty to enable appellant to prepare his defense, within the meaning of the Sixth Amendment of the Constitution, and in violation of appellant's right to due process of law within the meaning of the Fifth Amendment of the United States Constitution.

5. The District Court erred in denying appellant's motion for production and admission of records showing the amount of money paid the witness Harley Mores by the Federal Bureau of Investigation from 1942 until 1953, including a monthly statement of the monthly sums paid during that time, in the following particulars:

a. The District Court erred in denying appellant's demand for said records, on the ground that said records, namely receipts which the witness testified to having signed for all moneys paid him, would impeach the witness' testimony, to the effect he had testified that he has received said money only as "expense" money and that there was no element of profit, and appellant offered to prove by the said receipts that said testimony was untrue (R. 333, 335, 336, 369-370);

b. The District Court erred in denying said motion, on the further ground that said documents constituted essential and material evidence going to the veracity and credibility of the witness (R. 334), and to show

that the amount of money received by the witness was considerably greater than the amount testified to (R. 335);

c. The District Court erred in denying said motion, of appellant, on the further ground that the alternative decision of the court, namely, to allow presentation by appellee of a statement purporting to represent the total amount received by the witness (R. 367), in lieu of the precise statements demanded by appellant as set forth above, as related to a conflict as to whether or not the money received by the witness was expense money or compensation, and that the evidence demanded was relevant and material as going to show the witness' "interest" and motive (R. 369-370);

d. The District Court erred in denying appellant's renewed motion for production of said receipts showing all payments made to the witness Mores, on all of the above stated grounds, at the conclusion of appellant's case (R. 749).

6. The District Court erred in allowing the witness Clark Harper to "explain" an answer which did not call for explanation, and in failing to strike the highly prejudicial "explanation" that was given (R. 410-412) as moved for by appellant on the ground that said "explanation" was highly prejudicial, speculative and did not constitute permissible direct testimony because of its opinion nature, since it permitted the government witness to give an opinion and speculate as to the guilt or innocence of the appellant.

7. The District Court erred in refusing to allow appellant's question, asked of the government witness

Clark Harper, and directed to show that on October 20, 1954, before the Justice Department Security Board, the witness had falsely testified under oath on two occasions, by falsely identifying two persons as having attended Communist Party meetings with the witness; that the question so directed was relevant, competent and material to show that the witness Harper had testified falsely under oath, or, in the alternative, at the very least, that the witness Harper is completely unreliable as a witness with respect to identification and testimony concerning persons with whom he has attended Communist Party meetings (R. 463-515).

8. The District Court erred in denying appellant's motion for judgment of acquittal made at the conclusion of the government's case (R. 647) on the following grounds:

a. That the evidence was insufficient to sustain a conviction;

b. That *a fortiori*, the evidence was insufficient within the meaning of the perjury rule, applicable to this case, requiring that the government prove the falsity of the alleged affidavits by the direct evidence of two witnesses, or the direct evidence of one witness supported by strong corroborative evidence;

c. That the indictment was and is insufficient and legally improper because of the multiplicity of counts, because, under the indictment, appellant was unable to prepare a defense, and because the indictment was insufficient to allege materiality (R. 647-691).

9. The District Court erred in denying appellant's

motion for judgment of acquittal filed December 1, 1954 (R. 24) on the grounds as set forth in Point 8 above.

9(A). The District Court erred in refusing to permit appellant to call United States Attorney Harris as a witness for the defense, and in refusing appellant's offer of proof showing that government witness Clark Harper did not have any direct knowledge of any alleged membership of appellant in the Communist Party, or of any activities of appellant carried on in support of or in relationship to the Communist Party (R. 692-699).

10. The District Court erred in denying appellant's motion for judgment of acquittal renewed at the conclusion of the trial, when the defense had rested, on the grounds set forth in Point 8 hereinabove (R. 863).

11. The District Court erred in instructing, and failing to instruct the jury, as follows:

a. In instructing the jury that circumstantial evidence is legal and competent as a means of proving the guilt of appellant, for the reason that the necessary quantum of proof in a case in which a necessary or material element is perjury, such must be proved by the direct evidence of one witness plus strong corroborative evidence, or evidence of two witnesses (843-844); and

in failing to give appellant's requested instruction No. 9, to the effect that that quantum of proof is necessary in such a case (Tr. 23);

b. In instructing the jury that in weighing the testi-

mony of witnesses paid by the government to join the Communist Party and report their activities to the Federal Bureau of Investigation, the jury should scrutinize such testimony with care and caution, and after consideration of such testimony, if the jury found said witnesses had testified truthfully, such testimony was as good as the truth testified to from any other source (R. 845-846) for the reason that such was an erroneous statement of the law with respect to such witnesses and in that said instruction was incomplete, in that the jury should have been instructed as follows:

“If you find that such witnesses have testified untruthfully, such testimony may be disregarded by you insofar as you decide it is untruthful, and when it is not corroborated from any other source;”

c. In instructing the jury as to the meaning of the words “member” and “affiliated” (R. 853-854) as used in the indictment in connection with the Communist Party; and in failing to give a true and proper definition of said terms, and in failing to give appellant’s requested instruction No. 14 (Tr. 23), defining said terms, for the reason that the court’s definition of said terms is not definition which applies by virtue of the Taft-Hartley Act and the legislative history of said Act, and the court’s definition being so vague and indefinite as to furnish the jury with no ascertainable standard of guilt;

d. In failing to instruct the jury as follows:

(1) In failing to give appellant’s requested instruc-

tion No. 10 (Tr. 23), containing a proper, adequate and legal definition of the term, "member of the Communist Party" (R. 869-870);

(2) In failing to give appellant's requested instruction No. 11 (Tr. 23) (R. 871), which could have instructed the jury that any evidence, or inference therefrom, relating to appellant's beliefs, was immaterial to any issue of the case and was to be disregarded;

(3) In failing to give appellant's requested instruction No. 15 (Tr. 23) containing cautionary instruction with respect to the testimony of witnesses who the jury might believe were testifying through hope of personal gain or benefit; and in failing to instruct the jury to scrutinize and scrupulously examine the testimony of the witness and determine whether there was any motive, interest, financial or otherwise, or any element of corruptive influence in their testimony against appellant.

12. The District Court erred in denying appellant's motion for arrest of judgment (Tr. 29) (Tr. 33), and motion for judgment of acquittal or, in the alternative, for a new trial (Tr. 28) on the grounds set forth in Points 1 through 9, hereinabove, and on the further ground that the United States Attorney committed prejudicial error in his closing argument to the jury (R. 826-836), calculated to arouse the bias of the jury, in his reference to Alger Hiss, his reference to appellant's counsel (quoting from the "Christian" Bible) and in his appealing to the passions of the jury by characterizing the Communist Party (with reference

to matters not in issue), and by an unwarranted attack upon one of appellant's counsel.

Without waiving any of the points stated above, appellant intends to argue herein that the appellant was deprived of a fair trial in that:

1. (a) The indictment did not set out the necessary essentials of the offense charged, nor did it set forth with sufficient clearness, precision and certainty, the time, place and manner in which the offenses are alleged to have been committed, and is vague and indefinite to the extent that appellant was unable to prepare a proper defense.

- (b) The indictment, and count thereof, is further vague and indefinite because it does not advise nor inform a defendant of that with which he is charged, and it contains vital inconsistencies and contraction between the charges alleged in counts one and three, and the charges alleged in counts two and four.

- (c) The indictment is invalid because it alleges and splits three alleged offenses into six inconsistent and multiplicitous counts.

2. The trial court admitted irrelevant and incompetent evidence and prejudicial evidence.

3. The trial court excluded relevant evidence offered by appellant.

4. The jury was erroneously instructed.

5. The trial court erred in denying appellant's motion for judgment of acquittal or in the alternative for a new trial.

ARGUMENT

Point I.

APPELLANT WAS DEPRIVED OF A FAIR TRIAL THROUGH THE INFIRMITIES OF THE INDICTMENT.

A. The Indictment Did Not Set Out the Necessary Essentials of the Offense Charged Nor Did It Set Forth with Sufficient Clearness, Precision and Certainty, the Time, Place and Manner in Which the Offenses Are Alleged to Have Been Committed and Is Vague and Indefinite to the Extent that Appellant Was Unable to Prepare a Proper Defense.

The indictment charges a violation of the False Statements Act (18 U.S.C. 1001) in that the defendant filed with the National Labor Relations Board an affidavit which falsely denied membership in (first, third and fifth counts) or affiliation with (second, fourth and sixth counts) the Communist Party.

The Act is applicable to, and the National Labor Relations Board has jurisdiction only over, certain aspects of labor relations involving employees engaged in interstate commerce or in the production of goods for interstate commerce. It provides that no labor organization of such employees may use the facilities of the Board unless each of its officers annually files with the Board an affidavit that

“he is not a member of the Communist Party or affiliated with such party, and that he does not believe in, and is not a member of or supports any organization that believes in or teaches, the overthrow of the United States Government by force or by any illegal or unconstitutional methods.”
(29 U.S.C. 159(h))

The constitutionality of this affidavit "as herein construed" was upheld by an equally divided 3-3 court in *American Communications Association v. Douds*, 339 U.S. at 415, 94 L.ed. 925, at 953. In *Osman v. Douds*, 339 U.S. at 846, 94 L.ed. 1328, the vote became 4-4. The court, Mr. Justice Black dissenting, upheld that part of the statute, as construed by the prevailing opinion, which was concerned with membership in or affiliation with the Communist Party, Mr. Justice Frankfurter dissenting as to "affiliation." With respect to the balance of the affidavit the court was equally divided, the Chief Justice, Justices Reed, Burton and Minton voting to uphold the statute as construed by the prevailing opinion, and Justices Black, Douglas, Frankfurter and Jackson dissenting. *Osman v. Douds, supra*, at 847-S².

Defendant contends that the indictment is fatally defective because it fails to set out the necessary essentials of the offense as defined in 18 U.S.C. 1001 and also because it fails to comply with the construction of the affidavit read into it by Douds in order to save it from unconstitutionality.

The ingredients of the offense under 18 U.S.C. 1001 are:

² It is well settled that affirmance by an equally divided court concludes the parties but is not a precedent either in the Supreme Court or the lower courts. *Hertz v. Woodman*, 218 U.S. 205; *Hanifen v. Armitage*, 117 Fed. 845. Mr. Justice Clark, whose vote would have been decisive, did not participate. It is noteworthy, however, that he was Attorney General at the time that the President vetoed that Act, among other reasons, because of the presence of the affidavit requirement. (93 Cong. Rec. 7500, June 20, 1947, at 7503)

1. A false statement concerning
2. A material fact³
3. Knowingly and wilfully made
4. With knowledge of its falsity
5. In a matter within the jurisdiction of an agency.

(a) The indictment is insufficient because it fails to allege that the alleged false statements were material.

The indictment does not state that any of the alleged false statements were material, nor does it allege any facts to show their materiality. Since materiality is an essential ingredient of the offense by the express terms of the statute, the indictment is fatally defective on this ground alone. *Rolland v. United States*, 200 F.(2d) 678 (CA 5, 1953); *Cf.*, *United States v. Moore*, 185 F.(2d) 92 (CA 5, 1952); *United States v. Harris*, 104 F.(2d) 41; *United States v. Danaher*, 39 F.(2d) 325; *United States v. U.S. Cartridge Co.*, 95 F.Supp. 384, *affd.* 198 F.(2d) 456.

In the recent case of *United States v. Rolland*, *supra*,

³ Section 1001 has three clauses. "Material" appears only in the first. However, it is settled that this word modifies all three clauses and that an immaterial statement although false, is not within the purview of any clause of the statute. *United States v. U.S. Cartridge Co.*, 95 F. Supp. 384 (E.D. Mo. 1950), *affirmed*, 198 F.(2d) 456 (CA 8); *United States v. Moore*, 185 F.(2d) 92 (CA 5 1950); *Lea v. United States*, 167 F.(2d) 13 (CA 6 1948); *Harris v. United States*, 104 F.(2d) 41 (CCA 8, 1939); *Danaher v. United States*, 39 F.(2d) 325 (CCA 8, 1930); *Rolland v. United States*, 200 F.(2d) 678 (CA 5, 1953).

defendant were indicted under 18 U.S.C. 1001 for false statements concerning the earnings of their employees "in a matter within the jurisdiction" of the wage and hour and public contracts division of the Labor Department. In dismissing the indictment for insufficiency after defendants had been convicted thereon, the court said (at 679-80):

"The challenged counts here do not allege that the statements complained of were 'material,' they do not state facts which show them to be.

"Count one does charge that the defendants 'made and furnished . . . a statement setting forth' . . . that the defendants had paid one Ward the sum of \$94.47 when they well knew that such payment had not been made. It does not, however, allege that the statement was 'material,' nor does it allege, that that amount was actually due to the employee named . . . Count One of the indictment failed to charge an offense in that neither in *haec verba*, nor in substance, did it charge the essential fact that the complained of statement was material."

To the same effect is *Harris v. United States*, 104 F.(2d) 41 (CCA 8, 1939).

This indictment does not allege that the statements were material. Nor does it state facts to show their materiality. In order for the statements to be material they would have had to have been filed for the purpose of securing "compliance" with the Act with the intent that the facilities of the Board be made available to the union, and that they were made in a matter affecting interstate commerce and by an officer of a labor organization as defined by the Act. The indictment contains none of these allegations which might substitute for the

failure to allege materiality. The allegation that the statement was made in a matter "within the jurisdiction" of the Board is insufficient because 18 U.S.C. 1001 requires both that the statement be within the jurisdiction of the agency and that they be material, as *Rolland* points out. In that case there was an allegation that the false statements were "within the jurisdiction" of the agency but the indictment was nevertheless held invalid because it omitted to state that they were material or how they were material.

Since none of the counts alleges "materiality" the indictment is insufficient as to each count.

An indictment must set out every element of the crime expressly embodied in the statute (*Moore v. United States*, 160 U.S. 268; *Anderson v. United States*, 294 Fed. 593 (CA 2); *United States v. McGuire*, 64 F.(2d) 485 (CA 2); *Sutton v. United States*, 157 F.(2d) 661 (CA 5); *United States v. Valenti*, 74 F.Supp. 718 (W.D. Pa.) and, in addition, every element of the offense which, although not expressly set forth in the statute, has been held, by interpretation or otherwise, to be an essential ingredient thereof. *United States v. Carll*, 105 U.S. 611, at 612-3. See also *Pettibone v. United States*, 148 U.S. 197; *Keck v. United States*, 172 U.S. 434.

In particular, where a statute is couched in broad terms and on its face embraces wider restrictions than the court is willing to sanction, the indictment must allege *the concrete facts which bring the offense within the permitted area of the statute*. *United States v. Hess*, 124 U.S. 483; *Potter v. United States*, 155 U.S. 438;

Anderson v. United States, 294 Fed. 593 (CA 2). See also *United States v. Cruikshank*, 92 U.S. 542, at 557-8.

In *Screws v. United States*, 325 U.S. 91, the Supreme Court held a provision of the Civil Rights Act to be constitutional only if construed to require a specific intent. An indictment which failed to charge the intent required under this judicial construction was held insufficient. *Pullen v. United States*, 164 F.(2d) 756 (CA 5). See also *United States v. Britton*, 107 U.S. 665; *United States v. Korner*, 56 F.Supp. 242; *United States v. Specht*, 57 F.Supp. 79.

The requirement that the essential elements of the offense be stated with particularity is especially important where the statute is couched in broad terms, is potentially applicable in a wide variety of circumstances and to numerous individuals, and imposes restrictions upon basic democratic rights. In the leading case of *Fontana v. United States*, 262 Fed. 283 (CCA 8) Judge Sanborn, speaking for a unanimous court on this point, said (at p. 288) :

“It is an elementary rule of criminal law that when language does not constitute a crime if uttered under some circumstances, and does constitute a crime if uttered under other circumstances, it is not enough to charge that it was used with intent to violate the law. That would be a mere conclusion. The facts must be set forth, so that the court can determine, and not the pleader, whether or not they constitute the crime.”

See also *United States v. Schutte*, 252 Fed. 212 (D.C.N.D.) ; *Foster v. United States*, 253 Fed. 481 (CA

9) ; *Collins v. United States*, 253 Fed. 609 (CA 9) ; and *United States v. Ault*, 263 Fed. 800 (D.C.W.D. Wash.).

The prevailing opinion in *Douds*, expressly to save the statute from unconstitutionality, construed it as follows :

1. The statute is valid as a regulation of interstate commerce in the face of a danger of political strikes from Communist leaders and those who hold a belief in violent overthrow "other than loyalty to the Communist Party." 339 U.S. at 388, 392-3.
2. The "belief" referred to is belief in forcible overthrow, but only if such belief is held as an objective and not as a prophecy (at 407).
3. The affidavit is not intended to "force disclosure of attitudes on all manner of social, economic, moral and political issues." (at 410).
4. The prescribed belief, as the prescribed membership, must be "outwardly" manifested by overt acts. (id, at 411).
5. The standard to be applied to the terms "affiliated," "support" and "illegal and unconstitutional means" is not to be abstract, but is to be determined by "the practical criterion of fair notice to those to whom the statute is directed. The particular context is all important." (at 412).
6. The statute applies only to acts done "with knowledge" that they contravene the statute. (at 413).
7. The act is not concerned with "*past actions*" (at 413), (emphasis in original). "Past conduct, actual or threatened by their previous adherence to affiliations and beliefs mentioned in 9(h) is not a bar . . . to resumption of the position" (at 414).

Thus, under a constitutional construction of 159(h),

the following minimum requirements must be met by an indictment charging a false affidavit:

1. Allegations concerning "affiliation" and "support" are not to be abstract or bare; they must be factually stated, alleging the overt acts, so as to meet "the practical criterion of fair notice."
2. The indictment must be narrowly drawn so as to reach only the "noxious ideology" of forcible overthrow (*Kendroff v. St. Nicholas Cathedral*, 344 U.S. 118); it may not reach "all manner of social, economic, moral and political issues" (339 U.S. at 410).
3. It must state the facts showing the probability of political strikes arising from the conduct of the defendant.

(b) The crux of the Second, Fourth and Sixth Counts is the bare charge of "affiliation."³

To the extent that "affiliation" contemplates something other than membership, which is the basis of the First, Third and Fifth Counts (which it must, since otherwise the First and Second Counts, Third and Fourth Counts, and Fifth and Sixth Counts, would be redundant) it is so vague, uncertain and indefinite as to set no intelligible standard of prescribed conduct and to give no fair or adequate notice of the offense charged.

³ It may be noted in passing that whatever "affiliation" may mean, it necessarily embraces a relationship which has incidents and concepts which are different from "membership." Cf. *Bridges v. Wixon*, 326 U.S. 135, 89 L.ed. 2103. Consequently the First and Second Counts are repugnant and cannot stand together as we show below.

The term "affiliated" is of "dubious scope." Frankfurter, J., in *Douds, supra*, at 420. No definition of the term is contained in the statute, nor does any clear definition appear from the committee reports or the legislative debate. The limited judicial discussion of the term affords no guide. The leading case of *Bridges v. Wixon*, 326 U.S. 135, 89 L.ed. 2103, turned on a *statutory* definition under the immigration statutes. And even with the guidance of that statute—which defined affiliation as including those who contributed money or anything of value to an organization which advocated forcible overthrow—the court could not define the term except as importing something "less than membership but more than sympathy" (326 U.S. at 143)⁴. Judge Major, in his dissent in *Inland Steel Co. v. National Labor Relations Board*, 170 F.(2d) 247, said of the discussion of the term "affiliation" in *Bridges* "that its meaning would be quite beyond the reach of the ordinary citizen." In *United States ex rel Kettunen v. Reimer*, 79 F.(2d) 315 (CCA 2), Judge Chase refused to give a comprehensive definition of "affiliation" as used

⁴ In the proceedings under review in *Bridges*, Dean Landis had reached one definition of "affiliated," Judge Sears another, only to be reversed by the Board of Immigration Appeals, which was in turn reversed by the Supreme Court, which held that the Attorney General had given the term "a looser and more expansive meaning than the statute permits." In view of the sharp disagreement concerning the meaning of the term among men who are specialists in language, even with the assistance of a statutory definition, the uncertain and indefinite nature of the term "affords little more than a fertile field for speculation and guess." Major, J., at 170 F.(2d) 247, 262.

in the deportation statute, saying: "Very likely that is as impossible as it is now unnecessary."

Under these circumstances observance of the injunction in the prevailing opinion in *Douds* that the term is to be judged by the "particular context" in which it is employed and by the "practical criterion of fair notice" to those to whom it is directed is imperative. Standing alone, it has no meaning by reason of the diverse meanings which may be attributed to it.

Under this indictment the charge of affiliation is made in no context. The indictment affords not the slightest hint as to the meaning or application attributed to it by the grand jury or as to what the defendant is called upon to meet. But under *Douds* the charge of "affiliation" must be defined and the defendant must be informed as to what conduct of his, in the Government's view, constituted "affiliation." The indictment must also charge that the defendant knew that such specified conduct constituted "affiliation." In the absence of such allegations the charge of affiliation is a mere "abstraction" which *Douds* holds is insufficient.

Such a general charge does not inform the defendant of that with which he is charged or enable him to prepare his defense. As the court said in *Fontana v. United States*, 262 Fed. at 286:

"... when one is indicted for a serious offense, the presumption is that he is innocent thereof, and consequently that he is ignorant of the facts upon which the pleader founds his charge, and it is a fundamental rule that the sufficiency of an indictment must be tested on the presumption that the

defendant is innocent of it and has no knowledge of the facts charged against him in the pleading.”

It is impossible to ascertain from the indictment the meaning of the charge of affiliation or what acts comprised such affiliation. But for an indictment to be sufficient, “the facts must be set forth, so that the court can determine, and not the pleader, whether or not they constitute the crime.” *Fontana v. United States, supra*, at 288. Facts must appear *from the indictment* which “will, if proved, support a conviction for the offense alleged.” *Cruikshank*, 93 U.S. 542, at 559. Here, however, only the conclusion of the pleader is stated.

It cannot be suggested that this indictment gives to the accused adequate notice in a criminal case of that which he is charged. If the status of affiliation is definable, or was intended by the grand jury to convey a meaning, it should have been defined in the indictment by a statement of the facts claimed to create the status. If it is undefinable it is ineffective to allege an offense. Thus under either alternative, whether undefinable or definable but undefined, this count is invalid. *United States v. Cohen Grocery Co.*, 255 U.S. 81, 65 L.ed. 516; *Lanzetta v. New Jersey*, 306 U.S. 451, 83 L.ed. 888; *Winter v. New York*, 333 U.S. 507, 92 L.ed. 840; *Cline v. Frink Dairy Co.*, 274 U.S. 445, 446; 71 L.ed. 1146; *International Harvester Co. v. Kentucky*, 234 U.S. 216, 221; 58 L.ed. 1284; *Champlain Refining Co. v. Corporation Commission*, 286 U.S. 242; 76 L.ed. 1062; *United States v. Cardiff*, 344 U.S. 174; *United States v. Capital Traction Co.*, 34 App. DC 592; *United States v. Hatau*, 43 F.Supp. 507.

(c) The present indictment is based upon the False Statements Act.

("... makes or uses any false writing or documents ...") (18 U.S.C. 1001)) and not the perjury statute ("... states or subscribes any material matter which he does not believe to be true ..." (18 U.S.C. 1621)). Thus, the territorial jurisdiction of this court in this case is based solely and only upon the three acts of filing the affidavits referred to in the indictment. *United States v. Valenti*, 207 F.(2d) 242; *United States v. Lombardo*, 241 U.S. 73, 60 L.ed. 897.

The making or filing of a single false writing or document can constitute but one offense, regardless of whether one or more false statements are therein contained. *United States v. Eisler*, 75 F.Supp. 634 (D.C., D. Col. 1947); *United States v. Manton*, 107 F.(2d) 834 (CCA 2); *Frowerck v. United States*, 249 U.S. 204, at 210, 63 L.ed. 561; *Magon v. United States*, 260 Fed. 811; *Anderson v. United States*, 269 Fed. 65. Each false statement does not and cannot constitute a separate offense under a single filing sufficient to support a separate count, since the jurisdiction over the offense arises from the filing and not from the false statements. *In re Snow*, 120 U.S. 274; *Kerr v. Squier*, 151 F.(2d) 308 (CCA 9); *Johnson v. Lagomorosino*, 88 F.(2d) 86 (CCA 9); *Braden v. United States*, 270 Fed. 441 (CCA 8); *Colston v. Johnston*, 35 F.Supp. 317 (DCND Col.); *Fawick Airflex Co. v. UERMWA*, 93 N.E.(2d) 480, 154 Ohio State 206; *People ex rel. Amarante v. McDonald*, 100 N.Y. Supp.(2d) 463; *Maxwell v. Rives*, 11 Nev. 213.

The vice of this indictment's effort to manufacture six offenses out of but three is aggravated by the inconsistency among the counts. As noted, the first count charges a status and relationship vis a vis the Communist Party incompatible with the status and relationship alleged in the second count.

Under any circumstances the law frowns upon and forbids splitting a single offense into multiple offenses. On the contrary it insists that simultaneous, unified conduct be treated as one offense, as in the classic examples of the theft of a flock of sheep or of a bag containing many pieces of mail. *Kerr v. Squier, supra*; *Johnston v. Lagomorosino, supra*; *Braden v. United States, supra*. Such a multiplication of offenses is oppressive under any circumstances; it is more so where the counts are inconsistent and incompatible as they are here. A single offense can no more be split into several counts than could a single offense be split into several indictments. Rule 8 of the Federal Rules of Criminal Procedure permits the joinder in separate counts in one indictment of "two or more offenses." There is no authority for assorting one offense in two counts, or three offenses in six counts. Cf. *United States v. Goldstein*, 168 F.(2d) 666 (CCA 2); *State v. Brinkley*, 354 Mo. 337; 189 S.W.(2d) 314; *Smith v. State*, 198 Ind. 70, 152 N.E. 277; 48 C.J. pp. 885-886.

The indictment at issue is wholly insufficient. It is utterly uninformative; it does not even meet the elemental requirements of pleading under the False Statements

Act by its omission of allegations of materiality of scienter. It is multiplicitous and inconsistent. It ignores the construction imposed by *Doubs* to save the Act from constitutional infirmity. Further it makes vague and undefined charges which are invalid under the Fifth Amendment; it makes such charges abstractly without regard to the criterion of fair notice in a practical context and as though *Doubs* had never been written.

It suffices to say that what has been said heretofore provides the substantive basis for the motions for discovery and for bill of particulars.

The Government's argument is to the effect that defendant is not entitled to know the Government's case, but as BARRON points out in his *Federal Practice and Procedure*, Vol. 4, page 125:

“This, of course, works no harm to the habitual or confirmed criminal. He already knows the Government's case. The innocent defendant is the only one harmed by such an attitude.”

The defendant can, of course, in no way surmise what the Government means by “affiliation” and certainly a request addressed to the court in its discretion for particulars as to that term is not only reasonable, but absolutely necessary to a defense. It might be well to note that in the case of *United States v. Ben Gold*, in the District Court of the United States for the District of Columbia, Judge Holtzoff, an expert on rules, ordered the Government to supply a bill of particulars and also allowed an inspection and examination of certain documents.

Point II.

APPELLANT WAS DENIED A FAIR TRIAL IN THAT THE TRIAL COURT ADMITTED IRRELEVANT AND INCOMPETENT EVIDENCE PREJUDICIAL TO APPELLANT'S CASE.

The witness Harper testified directly that he had not seen the appellant at any Communist Party meetings that were restricted in their attendance to members of the Communist Party at any time after June 29, 1951, the date when the first affidavit was signed by appellant (R. 413). On cross examination Harper recollected only that he had seen Fisher in 1949 and not thereafter.

For that reason all of the testimony of the witness Harper was irrelevant. A statement that "it was very possible" appellant had been a member of the Communist Party before signing the first affidavit had no tendency to prove that he was a member when or after he signed it (R. 411-13). *Wolf v. United States*, 259 Fed. 388, C.A. 8 Cir.; *Kannann v. United States*, 259 Fed. 192, C.A. 7 Cir.; *Dalton v. United States*, 154 Fed. 461 (7th Cir.); *Colt v. United States*, 158 F.(2d) 641 (C.A. 5th Cir.); *State v. Wenzel*, 72 N.H. 396, 56 Atl. 918; *Pooley v. Dutton*, 165 Ia. 745, 174 N.W. 154.

The government did not intend to call this witness for the purposes of proving any part of the indictment (R. 385-6), but as an expert witness on the Communist Party, whose testimony would show that the Communist Party took extreme security measures to prevent the identification of its members from being known and such alleged matters as prohibitions by the party aimed at preventing more than two or three members from

meeting together. Originally, the court sustained appellant's objections to Harper's testifying as such an expert, but did permit questions as to the size of the Communist Party meetings held during different years (R. 387). The court, however, refused to allow the government to prove any Communist Party "policy" with respect to the signing of non-Communist affidavits (R. 388-398, 399-407). The witness then placed the appellant at a meeting on January 1, 1949, at the Frye Hotel, in Seattle, allegedly "an enlarged District Committee meeting of the Communist Party" (R. 409). (Presumably, this was the same meeting referred to by Harley Mores as having taken place in December, 1949 (R. 107). After the testimony concerning this alleged meeting, the witness was asked by the government whether or not he had seen the defendant at any Communist Party meetings after that date, i.e. Jan. 1, 1949, and answered:

"A Well, actually I do not remember. I don't recall whether I seen him since then or not at meetings because—may I explain?

Q Yes."

Counsel for appellant objected, and the record reads as follows:

"MR. ETTER: Well, now, I think the question is answered without any explanation, whether he seen him. He said he didn't think he saw him since.

THE COURT: I think he may explain the answer. You might proceed. If there is some objectionable feature to the answer, counsel may interject an objection.

A It is very possible that I have seen Mr. Fisher

at other meetings, but during that time, there was such high security measures taken in the Party and only three people were supposed to meet at a time, and it made it very difficult for quite a number of people to get together anywhere in one place, so, without being definite on it, I don't recall at the moment, to be definite, of seeing Mr. Fisher after that particular meeting.

MR. ETTER: I move that all that be stricken. The statement like 'It is highly possible something may have occurred,' in a trial of this kind—

MR. HARRIS (Interposing): Could I ask one more question before your Honor rules?

MR. ETTER: No, it is highly prejudicial that it is highly possible that something may have occurred. It is speculating and guessing.

MR. HARRIS: I have asked just for—

THE COURT (Interposing): Well, he stated he did not actually recall seeing him since and he wished to qualify it by some explanation. I don't think it should necessarily be stricken.

MR. ETTER: He said it was highly possible. I submit that there is highly prejudicial, a statement of that kind in this case. It doesn't constitute direct testimony, that it is highly possible a man did something.

THE WITNESS: Your Honor—

THE COURT (Interposing): The conclusion of 'highly possible' I think might be—the word 'highly' I think might be stricken. I think the word 'possible' might remain. The Court will strike that, because it is the conclusion or type of description of 'possible' that I think is improper, but I would only strike that portion of his answer, that word 'highly.'

By MR. HARRIS:

Q Do you want to explain something further in that answer?

A Yes, may I?

Q I am going to ask, if there is further explanation, will you give it, please?

A Yes. Why I said—answered it like I did is because there is another meeting since then.

The reason I said 'possible' is that there was a District Committee meeting since then which was a Convention, and I am not too sure whether I saw Mr. Fisher or not. It is possible that I did see him there. I am not sure.

MR. ETTER: I object. That isn't responsive to any question. That is not a further explanation, and I think it should be stricken.

THE COURT: The question is whether you have seen him subsequently, and the witness is giving his best recollection, and it is a question for the jury to determine what the weight of that answer is, and the Court will deny any motion to strike."

Thus, the witness Harper was allowed to speculate before the jury and to have such speculation considered by the jury with reference to the main facts in issue, namely, whether or not appellant attended meetings which were limited in attendance to members of the Communist Party after he had signed the Taft-Hartley non-Communist affidavit the first time.

The general rule with respect to such type of testimony is that knowledge need not be positive or absolute and a belief or impression based upon observation that signifies the degree of positiveness or a witness is admissible. On the other hand, as stated by Wigmore,

“What the courts repudiate then is a mere guess, the exercise of the imagination, a system, a conjecture, offered in place of the results of actual personal observation; it is from this point of view only that a “belief” or “opinion” or “impression” is not to be received.

In connection with this statement of the rule observe the testimony quoted above in which the witness states, “Actually, I don’t remember.” The witness asks as a further answer to the statement that he did not remember, “May I explain?” Counsel for defendant then objected on the ground that the question had been answered without any explanation, the court overruled the objection, and the witness then made the highly objectionable statement referred to that it is “very possible that I have seen Mr. Fisher at other meetings,” under the guise of an explanation that he did not remember.

Point III

THE TRIAL COURT EXCLUDED RELEVANT EVIDENCE OFFERED BY APPELLANT

A. Exclusion of Proof of Receipts for Money Received from F.B.I. by Witnesses Harley Mores and Mazie Mores.

On direct examination the Government asked the witness Harley Mores “From 1942 to 1953, what in your best estimate, would be the total amount of money that you received?” The Witness: “Well, I estimated that once before at ten thousand dollars. I don’t know whether that was close or not” (R. 144).

In the face of the witness’s statement that he did not know the amount of money, the witness was asked on

cross examination if he had had occasion to check the amount of money received from 1942 to 1953 from the Federal Bureau of Investigation, the witness stated that he did not have any way that he could check that, whereupon appellant's attorneys demanded that the information be produced in court and submitted (R. 326).

The witness had previously testified that he was compensated only for expenses; that is, the money that he was "actually out" (R. 244 and R. 246). He also testified that each time he received money the Agent had a receipt that the witness, Mores, signed, showing the amount of money received. He stated that "When the Agent came with the money he came out with a receipt and the amount of money was already written there" (R. 248).

In this connection he denied that any phone calls were made to the Federal Bureau of Investigation Agent (R. 249). Although the witness admitted that he had figured up the amount of money prior to the Smith Act trial in May (R. 252) he also admitted that when counsel asked him at the Smith Act trial what the amount of money was that he couldn't give an answer on the amount (R. 253). Further, on cross examination, although the witness had previously testified on direct, as quoted above, that he didn't know whether ten thousand dollars "was close or not," he admitted on cross examination that ten thousand dollars was close (R. 257) and later on he had qualifiedly admitted that "that was about the amount I was paid."

It was in the face of such contradictory testimony

that counsel for appellant demanded the actual receipts. The matter was argued before the court (R. 329-341). The court's ruling was based on the contention that the receipts which had been signed by the witness were confidential documents (R. 333) and counsel for appellant demanded at least an inspection of the documents to determine "the method, mode and extent of payment" (R. 333-334).

The final ruling of the court was that the Government might supply a certification as to the total amount paid to the witness, Harley Mores, and that it was "not sufficient reason" to justify the court to require the Government to disclose these records of the F.B.I., they being under the order of the Attorney General declaring them, and the statute declaring them, would be confidential documents.

Counsel for appellant made additional objections and excepted to the rule (R. 369-371). The Government did produce a court certification showing sums of money received by the witness, Harley Mores, and totaling more than ten thousand dollars (X. 105 and R. 748). The exhibit was offered into evidence by the defendant without waiving defendant's objections previously made to the failure to produce the actual receipts (748-749).

The certification thus offered into evidence was merely a summary of the amounts received and did not show any breakdown into actual payments made so that it was impossible to verify the authenticity or correctness of the calculations, and although defendant does not contend that the figures were not accurate as

far as they went it is almost certain that the actual receipts would have proven conclusively that the witness, Harley Mores, was not paid on the basis of expenses but was paid actual sums of money for his testimony and that the amount of his compensation actually depended upon the type of disclosures and the testimony that he was willing to give.

It is submitted that there was no possible justification for refusing admission of receipts under the guise that such receipts were confidential, since it is submitted the receipts would have impaired the credulity of the witness's testimony and would have been of the highest relevance with respect to the bias and interest of the witness since that witness undoubtedly was within the rule requiring cautionary instructions to the jury when the amount paid to such witness, or the extent of his pay, depends on the extent of his employment, and the extent of his employment depends on the discoveries he is able to make.

As we have shown in the cases cited, under Point 4 (*infra*) with respect to such a cautionary instruction the matter of compensation was of the greatest importance and the refusal to submit the receipts was prejudicial error.

The admissibility of all the facts and circumstances connected with the compensation of a witness has been universally recognized. With respect to showing the bias of a witness it is stated in Wigmore that such facts "may be offered either by extrinsic testimony or by

cross-examination, without discrimination against the former" (III Wigmore on Evidence, Sec. 948, p. 498).

In Section 949 of Wigmore (*supra*) in discussing "the range of external circumstances" from which bias may be inferred it is stated that "the relation of employment present or past is usually relevant," and this is reiterated in Section 969 wherein it is stated that: "The circumstances which give to a witness an interest in the event of the cause and may therefore be suggestive of testimonial doubt or detraction have usually a significance so apparent that it is either idle to dispute or useless to maintain their admissibility."

B. The Exclusion of the Testimony of Richard Harris to show prior Inconsistent Statements of the Witness Harper.

As was pointed out in Point II, the Government did not intend to call the witness Harper for the purpose of proving any material part of the indictment but as an expert witness of the Communist Party (R. 385-386). Although the court ruled out the testimony of Harper as an expert witness he nevertheless permitted the witness Harper to testify to many irrelevant, immaterial and prejudicial matters (See Point II, *supra*).

At the commencement of the defendant's case the court was informed of the intention to call the Assistant United States Attorney Richard Harris as a witness to testify that based upon his conversation with the Government's witnesses he knew that Harley Mores was the only witness "showing Mr. Fisher's implication in this case."

The testimony of Mr. Harris was further offered to "impeach" the testimony of the witness Harper with respect to his knowledge of the defendant and particularly with respect to his testimony about having informed the Government of all his knowledge some two weeks before, "and then only again immediately prior to the case, which he described to the jury," (R. 697-698).

It is submitted that this is particularly important to the defendant in that the witness Harper, after his testimony as an expert witness had been excluded, was allowed to speculate and to state "It is very possible that I have seen Mr. Fisher at other meetings," when, as defendant offered to prove that same witness had informed the Assistant District Attorney immediately prior to trial that he could not implicate the defendant, Fisher, directly. The testimony is further significant in view of the fact that Mazie Mores was called as a witness to implicate the defendant and to show that the Assistant District Attorney had been informed that she could not implicate the defendant.

Although it is true the witness Harper and the witness Mazie Mores's testimony was very vague and did not directly implicate the defendant, in fact as has been shown their actual knowledge was such that the Government did not intend to call them as witnesses, nevertheless their testimony did create a prejudice which could have been partially corrected by the relevant testimony of the Assistant District Attorney showing such prior inconsistent statements.

C. The Trial Court Erred in Excluding Proof of Harper's Prior False Identifications under Oath in a Case Involving Communist Party Membership.

During a cross examination of the witness Harper, the witness admitted that he testified under oath before a Justice Department Security Board on October 20, 1954. The witness was then asked :

“Q And you there identified, or, rather, that was a hearing involving a Federal employee, was it not ?

A That is right.

Q And you had reported that you knew this employee to be a member of the Communist Party, and to have attended meetings ?

A No, I didn't.

MR. HARRIS: Just a moment. I will object. I don't see the materiality, Your Honor, in this case.

THE COURT: I am inclined to sustain the objection unless there is some further showing.”

By the fact that the court sustained the objection it appeared that defendant's counsel was precluded with reference to that entire line of testimony whereupon defendant's counsel made an offer of proof proposing to show that the said hearing and while testifying under oath concerning a particular Federal employee whom he had seen twice in the same year prior to the hearing, and while under oath for the purpose of identifying him had, on two successive occasions, identified the wrong man as being the one he claimed to be a Communist Party member. The court indicated that there was no foundation for such questions. This was agreed to by counsel for defendant, saying that he wanted to lay the proper foundation but that this had been ob-

jected to (R. 465-6-7). The purpose of the questioning was explained to the court as showing the witness's powers of observation and identification and, secondly, for purpose of impeachment.

As counsel pointed out, there is a specific implication from the testimony of the witness that, he being a member of the Communist Party over a long period of time, and having attended more than a thousand closed Communist Party meetings at which nobody but Communists were present, he leaves the definite impression with the jury that because of his vast acquaintance and close intimate association with the functionaries and members of the Communist Party that when he refers to somebody as having been at a meeting and having been a Communist that he knows whereof he speaks.

In order to rebutt this impression and the testimony in the instant case it was certainly proper to show that in a similar case involving the identification of a person as a member of the Communist Party that the witness Harper had "not only a faulty memory, but a false memory" (See R. 477-484).

Counsel for the defendant also pointed out that the prior false testimony of the witness would go to show his motive in testifying in the instant case and certainly if the witness, who was a paid witness, testified falsely on three prior occasions that this would go to show a false and bad motive if not considered merely poor recollection.

After argument of counsel the court permitted defendant to again submit a question relating to the subject matter to the witness, sustained an objection to the question (R. 514-515) and permitted an offer of proof (R. 517-522).

Point IV

THE JURY WAS ERRONEOUSLY INSTRUCTED

A. The Perjury Rule Should Have Been Recognized and Applied by the Court in Its Instructions.

The court, when it instructed the jury with respect to the quantum of proof required in this case, stated as follows:

“Now, there are two cases of evidence—direct or positive, on the one hand, and circumstantial on the other.

“Direct or positive testimony is that which a person observes or sees, or which is susceptible of demonstration by the senses.

“Circumstantial evidence is proof of such facts and circumstances concerning the conduct of the parties which conclude or lead to a certain inevitable conclusion. Circumstantial evidence is legal and competent as a means of proving guilt in a criminal case, but the circumstances must be consistent with each other, consistent with the guilt of the party charged, inconsistent with his innocence, and inconsistent with every other reasonable hypothesis except that of guilt, and when circumstantial evidence is of such character circumstantial evidence alone, without any direct testimony at all, is sufficient to convict. You will review all of the circumstances in the light of this instruction.” (R. 843-844)

Appellant excepted to this instruction (R. 863-864) and requested the following instructions from the court:

“A. The Government must establish the alleged falsity of the statements made by the defendant by

the testimony of two independent witnesses or by one witness and corroborating circumstances. Unless this has been done with respect to each count, you must find the defendant not guilty with respect to that count."

"B. You cannot find the defendant guilty if the proof of falsity of the affidavit is merely circumstantial."

"C. If the falsity of any statement is supported by the testimony of only one witness with evidence of corroborating circumstances, you must find the defendant not guilty unless the corroboration is by proof of independent and material facts and circumstances tending directly to corroborate the testimony of the witness for the prosecution; and such proof must be of a strong character and not merely corroboration in slight particulars. Furthermore, the testimony of the prosecution's witness must, or you cannot find the defendant guilty, contradict in positive terms the statement of the defendant.

"As I have instructed you the plaintiff, government, must establish the falsity of the statements alleged to have been made by the defendant under oath by the testimony of two independent witnesses or by the testimony of one witness and corroborating circumstances. Unless that has been done, you must find the defendant not guilty.

"Two elements must enter into a determination by you that the corroborative evidence is sufficient or actually exists. The first element is that the evidence, if true, substantiates the testimony of a single witness who has sworn to the falsity of the alleged false, fictitious or fraudulent statement. The second element is that the corroborative evidenced is trustworthy."

The perjury rules should have been applied.

Unique rules of evidence apply in perjury cases. The falsity of the statement must be proved by direct evidence, and circumstantial evidence alone cannot support the conviction. The direct evidence must be the testimony of two witnesses or of one witness supported by strong corroborating evidence. If the evidence is not of such a character, the trial judge must not permit the case to go to the jury; and in any event the jury must be instructed that these rules must be satisfied. *United States v. Wood*, 14 Pet. (39 U.S.) 430, 441; *Hammer v. United States*, 271 U.S. 620; *Weiler v. United States*, 323 U.S. 606; *United States v. Otto*, 54 F.2d 277, 279 (2d Cir.); *Clayton v. United States*, 284 Fed. 537, 539 (4th Cir.); *Radomsky v. United States*, 180 F.2d 781, 782 (9th Cir.); *Phair v. United States*, 60 F.2d 953 (3d Cir.); *United States v. Palese*, 133 F.2d 600, 602 (3d Cir.); *Allen v. United States*, 194 Fed. 664 (4th Cir.); falsity of the statement must be proved by direct evidence. *McWhorter v. United States*, 193 F.2d 982 (5th Cir.); *United States v. Goldstein*, 168 F.2d 666 (2d Cir.); *United States v. Remington*, 191 F.2d 246, 249 (2d Cir.) cert. den. 343 U.S. 907; *United States v. Neff*, 212 F.2d 297, 306-308 (3d Cir.).

In the present case, the trial court refused to give the standard perjury instructions, requested by appellant.

Although this case was not brought under the perjury statute, the issue which had to be proved, and which the government sought to prove, was that the appellant had sworn falsely under oath when he executed the (9)(h)

affidavit. This alleged false swearing was perjury. 18 U.S.C., sec. 1621.

The question then is whether the perjury rules of evidence apply only in a prosecution under the perjury statute or whether they also apply in other criminal cases in which the issue is whether perjury was committed. On principle and under the authorities the question must be answered in the affirmative.

The special rules relating to the proof of perjury had their origin in the ecclesiastical courts. 7 Wigmore on Evidence (3d ed. 1940) sec. 2032; *United States v. Robinson*, 259 Fed. 685, 694 (S.D., N.Y.). Unquestionably they reflect the special religious or supernatural significance which has attached since primitive times to the ceremony of oath-taking and to the importance of keeping an oath.⁵ Accordingly, the doctrine evolved that any man's oath is as good as another's, and perjury cannot be proved by oath against oath. Wigmore, loc. cit.

The perjury rule has survived into modern times because experience has demonstrated that it conforms to the needs of modern society. It is a necessary protection against spiteful and unfounded prosecutions, *United States v. Nesselbaum*, 205 F.2d 93, 95 (3d Cir.), and "implicit in its evolution and continued vitality has been the fear that innocent witnesses might be unduly harassed or convicted in perjury prosecutions if a less stringent rule were adopted." *Weiler v. United States*, 323 U.S. 606, 609.

⁵ Cf., the Ninth Commandment and Psalms xxiv: "Who shall ascend unto the Mountain of the Lord? And who shall stand in His holy place? He that hath clean hands, and a pure heart; Who hath not taken My name in vain, And hath not sworn deceitfully."

In the present case the issue was whether appellant had made a false sworn statement. The case therefore is within the historic rationale of the perjury rule, which was based on the special quality of an oath. The case is likewise within the modern rationalization since the danger of harassment or conviction of the innocent on unreliable testimony is the same as if the case had been brought under the perjury statute. This fact is vividly demonstrated by the quality of the government's witnesses—professional informers in the pay of the prosecution whose lack of respect for the truth and penchant for making unfounded accusations are shown in this record.

As to precedents, *Hammer v. United States*, 271 U.S. 260, establishes that the perjury rules of evidence apply whenever false swearing is an issue in the case and not merely in perjury prosecutions. Hammer held that the perjury rules governed proof of the false statement in prosecutions for subornation of perjury.⁶ The court stated (at 629):

“The rule that the uncorroborated testimony of one witness is not enough to establish falsity applies in subornation as well as in perjury cases. * * * Falsity is as essential in one as in the other. It is the *corpus delicti* in both.”

So in the present case, the falsity of the sworn state-

⁶ Where the charge is soliciting the commission of perjury, the offense is complete without the taking of an oath. Since the theory of oath against oath is therefor not involved, it has been held that the perjury rules do not apply. *Culwell v. United States*, 194 F.2d 808 (5th Cir.).

ment was "as essential" as in a perjury prosecution, and the falsity was as much the *corpus delicti*.

Other cases bear out the principle of *Hammer*, that it is not the form of the action which calls the perjury rules into play, but whether false swearing is the matter to be proved. Thus the perjury rules must be applied even in civil cases where the issue is whether a person swore falsely—the typical case being an action for slander in which the defendant seeks to justify as true his statement that the plaintiff committed perjury. *Woodbeck v. Keller*, 6 Cow. (N.Y.) 118; *Clark v. Dibble*, 16 Wend. (N.Y.) 601; *Spruil v. Cooper*, 16 Ala. 791; *Laughran v. Kelly*, 8 Cush. (62 Mass.) 199, 202; *Coulter v. Stuart*, 2 Yerg. (Tenn.) 225.⁷ So in *Woodbeck v. Keller*, the court stated (at 119-120):

" * * * where, in an action of slander, a defendant justifies a charge of perjury, one witness is not sufficient to prove the truth of the charge, and sustain the justification. * * * Upon an indictment, the rule is well established and undisputed * * * and no ground of distinction is perceived, between the two cases. * * * And if, in (a criminal prosecution for perjury) the oath of the defendant is to be considered equivalent to the oath of a witness, why should not a like effect be given to it in a civil prosecution?"

Todorow v. United States, 173 F.2d 439 (9th Cir.), cert. den. 337 U.S. 925, is not to the contrary. There the

⁷ But through the direct-evidence, two-witness rule applies even in such civil cases, the one seeking to prove the falsity need not meet the criminal standard of establishing his case beyond a reasonable doubt. *Spruil v. Cooper*, *supra*.

court stated in a prosecution under the false-statement act, "There is no sound reason for invoking the perjury rule here." In *Todorow*, the charge was that the defendants had caused one Taylor to make false statements to a government agency. It does not appear that Taylor's statements were under oath. Moreover, the falsity of Taylor's statement was not disputed, and the only question in issue was whether the defendants had induced the statements. As the court stated (at 443-4):

"We are not called upon to sustain a finding that statements were false on the sole basis of 'an oath against an oath.' It was not disputed that Taylor made false representations in his application."

In *Todorow*, therefore, the court was merely applying the familiar rule that the perjury rules apply only to proof of the falsity of the statement, and not to proof of other matters, such as whether the statement was in fact made or induced.

B. The Court Did Not Give a Precautionary Instruction as to the Testimony of Professional Informers.

The court instructed the jury as follows:

"The evidence shows that certain of plaintiff's witnesses were in times past engaged by the government to join the Communist Party and make reports to the Federal Bureau of Investigation of such facts as they learned during such association; also that they were paid considerable sums of money while so engaged. In weighing the testimony of such witnesses in this case you should scrutinize their testimony with care and caution and after so considering their testimony give it just such weight as you believe it to be entitled to in view of all the

circumstances of the case as disclosed by the evidence. If you find they have testified truthfully such testimony is as good as the truth testified to from any other source." (R. 845-846)

The appellant excepted to the court's instruction and stated that the instruction was incomplete and not sufficiently cautionary. The appellant's instruction No. 5 (CTr. 23) should have been given.

"The testimony of the witnesses who were at the time of their testimony in the employ of the Department of Justice or who were paid directly for their testimony in this case must be examined with greater scrutiny and care than the testimony of an ordinary witness for the purpose of determining whether such testimony is colored in such a way as to place guilt upon a defendant in furtherance of the witness's own interest."

Harper and Mores, the two government witnesses, were Communists and they were paid special fees as informers.

The trial court refused to instruct the jury that the testimony of witnesses who were in the employ of the Department of Justice or who were paid directly for their testimony "must be examined with greater scrutiny and care than the testimony of an ordinary witness."

It is elementary that the testimony of the hired spy or informer should be received and employed with great caution. "(W)hen the amount of his pay depends upon the extent of his employment, and the extent of his employment depends upon the discoveries he is able to make, then that man becomes a dangerous instrument."

Sopwith v. Sopwith, 4 Sw. & Tr. 243, 247, 164 Eng. Repr. 1509. See also 2 May, Constitutional History of England (1863) 275-279. Even where a case is tried to the court without a jury, the testimony of such witnesses, "like that of all questionable witnesses, should not only be most carefully scrutinized, but received with great caution and reserve." *Allen v. Allen*, 52 App. D.C. 228, 231, 285 Fed. 962; *District of Columbia v. Clawans*, 300 U.S. 617, 630; *Moller v. Moller*, 115 N.Y. 466, 22 N.E. 169; *People v. Loris*, 131 App. Div. 127, 115 N.Y.S. 236. The character of the informers in this case and elsewhere amply justifies this skepticism. See Donner, *The Informer* (1954) 178 *Nation* 298.

When this case went to the jury appellant was entitled of right to have the requested cautionary instruction given. *Fletcher v. United States*, 81 App. D.C. 306, 158 F.2d 321; *McGinniss v. United States*, 256 Fed. 621 (2d Cir.). See also *Kelly v. United States*, 90 App. D.C. 125, 194 F.2d 150; *Gassenheimer v. United States*, 26 App. D.C. 432. Here, as in *Fletcher* and *McGinniss*, the entire case against appellant depended upon the testimony of professional hired informers.⁸ And the need for a cautionary instruction was even greater here than it was in *Fletcher* and *McGinniss*. Informer testimony is, of course, more readily falsified than factual testimony since it is less susceptible to cross-examination and rebuttal. Moreover, public opinion currently tends

⁸ Hence the case is unlike *United States v. Dennis*, 2 Cir. 183 F.2d 201, aff'd 341 U.S. 494, and *Richardson v. United States*, 208 F.2d 41, cert. den. 347 U.S. 1018, where there was documentary corroboration.

to assign to the political informer an undeservedly high veracity count.⁹

C. The Court Erred in Giving the Instructions Relating to "Membership" and "Affiliation."

That instruction was as follows:

"Now, certain of the terms or words of the indictment and statute here involved I will now define or explain to assist you in relating the evidence to the law of this case.

"As used in the indictment and statute the words 'member' and 'affiliated,' when applied to the Communist Party, have no unusual or different meaning apart from their normal or common usage.

"Webster's New International Dictionary defines 'member' as follows:

" 'One of the persons composing a society, community, or party; an individual who belongs to an association.'

" 'Affiliate' is defined as follows:

" 'To connect or associate one's self with; to

⁹ Curiously enough, the political informant, spy or agent provocateur is not now regarded with the same opprobrium as his brother who participates in other types of crime. Public opinion being what it is, his credibility is at a premium. His veracity count exceeds that of his more orthodox and less eccentric fellows. He may admit to all kinds of past knavery and mendacity but the greater his self-debasement the greater his claim to belief. That he now acts from patriotic motives is conclusively presumed." Donnelly, *Judicial Control of Informants, Spies, Stool Pigeons, and Agents Provocateurs* (1951) 60 Yale L. J. 1091, 1126. See also Chafee, *Spies into Heroes*, 174 Nation 618 (1952); Golat, *The Informer: His Role in the Breakdown of the Government* (1954) 77 N.J.L. No. 37, p. 1.

adopt, hence usually to bring or receive into close connection; to ally.' ” (R. 853-854)

The appellant excepted to the court's instruction and to the failure to give his requested instruction No. 10, on the ground that the instruction given was and is now a proper definition of the term included therein, particularly because such definition as the court included did not and do not conform to the meaning intended in the Taft-Hartley act, as shown by the legislative history of the act; and on the further ground that the instruction of the definition given by the court was so vague and indefinite as to furnish the jury with no ascertainable standards of guilt.

The appellant's requested instruction was as follows:

“With respect to Counts I, III, and V it is necessary that I instruct you in the meaning of the phrase ‘member of the Communist Party.’

“A. Membership in the Communist Party is a formal relation between an individual and the Communist Party which is defined by the rules and regulations of the Party.

“B. Not every relationship between an individual and an organization constitutes membership. An individual may be sympathetic or agree with all or part of the program of an organization and co-operate actively with it and still not be a member.

“C. In the present case you have had introduced in evidence the constitution of the Communist Party. In order for you to find that the defendant was a member of the Communist Party on June 29, 1951, as alleged in Count I of the indictment you must find beyond a reasonable doubt that, as of

that date, the defendant satisfied the requirements of membership as set forth in the Constitution of the Communist Party.

“D. In that connection I instruct you that the provisions of that constitution set forth as conditions of membership that a member is one who ‘accepts the aims, principles, and program of the Party, as determined by the constitutions and conventions, who holds membership in and attends club meetings, who is active on behalf of the Party, who reads the Party press and literature and pays dues regularly.’

“E. In order to find that the defendant is guilty of the charge in Count I, you must find that the conditions of membership as set forth in the Constitution were true on June 29, 1951, and that on that date the defendant believed that these conditions obtained, and believed that he formally was a member of the Communist Party. If you do not find beyond a reasonable doubt that the defendant regularly paid dues, attended meetings, and accepted the program of the Communist Party on June 29, 1951, or if you do not find beyond a reasonable doubt that the defendant considered himself to be a member of the Communist Party at the time he signed the affidavit, then it is your duty to acquit as to said Count I.

“F. The same rules apply in determining the guilt or innocence of the defendant with respect to Counts III and V of the indictment with respect to membership in the Communist Party.” (Tr. 23)

Membership in an organization which has formalized requirements for membership is determined by the prescribed requirements. That was the exclusive test em-

ployed in *United States v. Reimer*, 79 F.2d 315 (2d Cir.), in determining membership in the Communist Party. It was the sole test employed also in *Kubilius v. Hawes*, 322 Mass. 638, 79 N.E.2d 5, and *State v. Vrowell*, 9 N.J.L. (4 Halst.) 390, in determining church membership, and in *Traders' Mutual Life Ins. Co. v. Humphrey*, 109 Ill. App. 246, in determining membership in a fraternal order. Moreover, in *Kuilius v. Hawes*, *supra*, those who had failed to comply with one of the formal membership requirements specified in the church by-laws were held not to be members even though it was found that the requirement had been "commonly disregarded," in the absence of any showing that it had been waived as to the persons whose membership was in question.

The fact that there was testimony from some of the government's witnesses that it was not always necessary for a member to comply with some of the provisions of the constitution (payment of dues and attendance at meetings) does not affect the applicability of the stated principle to this case. This testimony was irrelevant in the absence of a showing that some such special arrangement had been made between appellant and the organization.

The test that membership is to be determined by the rules of the organization is also in accordance with common understanding. And since, under 18 U.S.C. §1001, "punishment is restricted to acts done with knowledge that they contravene the statute" and "no honest, untainted interpretation * * * is punishable," *American Communications Association v. Douds*, 339 U.S. 382,

413, appellant was entitled to have the jury measure the truth or falsity of his affidavit by that test. *Cf.*, *United States v. Harriss*, 347 U.S. 612, 620; *United States v. Rumely*, 345 U.S. 41, 47.

In refusing to incorporate this test in its instructions, the court left the jury free to speculate as to the meaning of membership and to test the truthfulness of appellant's denial of membership by some definition not known to appellant.

Even if the court disagreed with the appellant as to what the proper definition of membership was, it was still necessary for the court to give the jury some definition of the term. However, the instruction which the court gave failed to define the term at all and was vague and misleading.

As defined by the court, the term is not definite enough to satisfy the requirements of specificity applied to criminal indictments. Under the court's instructions "member" became as elastic and uncertain a concept as "sympathizer," *United States v. Lattimore*, App. D.C., No. 11849, decided July 8, 1954. That which will not suffice to apprise defendant, his lawyers and the court of the offense charged will not suffice to support a verdict of guilty on the charge.

Moreover, since the charge here is that appellant knowingly made a false statement in denying membership, and since the state of appellant's mind can only be shown by "outward manifestations" or overt acts (*American Communications Association v. Douds*, 339 U.S. 382, at 411), the jury should have been instructed as to those overt acts if any which they had to find in

order to infer that the appellant knew that he was a member. *United States v. Remington*, 191 F.2d 246 (2d Cir.), cert. den. 343 U.S. 907.

Having caused the jury at large to search for the intent of the appellant and of the Communist Party with respect to an undefined concept of membership, the court should at the very least have instructed the jury what not to consider. But it refused to charge that sympathy for or agreement with all or part of an organization's program, or co-operation with the organization, did not of itself constitute membership.

The House version of the Taft-Hartley Act (H.R. 3020, 80th Cong.) in 9f(6) forbade certification of a union by the National Labor Relations Board if one or more of its officers was a member of the Communist Party, "or by reason of active and consistent promotion or support of the policies, teachings and doctrines of the Communist Party can reasonably be regarded as being a member of or affiliated with such party." The Senate bill (S. 1126, 80 Cong.) did not contain a similar provision, but during debate on the floor Senator McCarthy proposed an amendment to permit labor unions to seek and employers to grant the discharge of a union member expelled from the union because of his "actively and consistently promoting or supporting the policies, teachings, and doctrines of the Communist Party." 93 Cong. Rec. 4879-4880. Senator Tydings objected to the quoted language as getting into a "twilight zone" so that the "examination might turn into a witch hunt" and Senator McCarthy then deleted the language objected to. *Ibid.*, pp. 4881-4882. The McCarthy amend-

ment was not agreed to (*ibid.*, p. 4884), but Senator McClellan proposed an amendment to the Senate bill incorporating the language of the House bill, and this amendment, after deletion of the word “teachings,” was agreed to. *Ibid.*, pp. 4894-4895. The conference committee, which wrote the final version of the Act as it now appears in §9h, deleted the entire clause which made promotion and support of Communist Party policies evidence of Party membership or affiliation. *Ibid.*, 6361, 6364.

Because the jury was given no comprehensible definition of membership, the statute as applied to appellant violates the due process clause of the Fifth Amendment. *Lanzetta v. New Jersey*, 306 U.S. 451; *Screws v. United States*, *supra*. Because the jury was left free to find an essential element of the crime on evidence of appellant’s beliefs, associations and advocacy which Congress cannot constitutionally proscribe, the statute as applied also violates the First Amendment. *Winters v. New York*, 333 U.S. 507.

We respectfully direct the court’s attention to the argument heretofore made under the first point in this argument, which related to the failure of the indictment in its charge of “membership” and “affiliation.”

Point V

THE COURT ERRED IN DENYING APPELLANT’S MOTION FOR JUDGMENT OF ACQUITTAL, OR, IN THE ALTERNATIVE, FOR A NEW TRIAL

A. The Verdict Was Not Supported by the Evidence Even Under Minimum Standards of Proof

In reviewing a denial of a judgment of acquittal the

general rule applicable is that a conviction based upon circumstantial evidence must be reversed unless the evidence excludes every other hypothesis but that of guilt, or if the evidence is as consistent with innocence as with guilt (Cyclopedia of Federal Procedure, 3d Ed., Vol. 11, Sec. 47.152).

The issue posed by the indictment was whether the appellant knowingly filed a false affidavit. The two affidavits in question, since the appellant was acquitted on the two counts which concerned the affidavit dated June 5, 1953, were executed on June 29, 1951, and July 11, 1952. The question under review, therefore, is whether the evidence supports the jury finding that on June 29, 1951, and July 11, 1952, the appellant was a member of, or affiliated with, the Communist Party.

The affidavit was in the present tense.

It is also important to stress that there was no effort made to prove the objective falsity of the affidavit with respect either to membership in the Communist Party or affiliation with the Communist Party. Although such objective falsity has been held to be the crucial fact to be proven in establishing in such a case as this that the accused "swore falsely."

Sec. 9(h) (29 U.S.C.A. Sec. 159(h) ;

American Communication Ass'n. v. Douds, 339
U.S. 382, 94 L.ed. 925.

See also, *cases construing the statute*:

United States v. Jennison, 26 Fed. Cas. 608
(No. 15, 475) ;

United States v. Moore, 26 Fed. Cas. 1304 (No.
15, 803) ;

United States v. Rhodes, 30 Fed. 431 (C.C. Mo.).

Cases holding that the prosecution has the burden of proving objective falsity from which to infer the accused's knowledge and intent:

United States v. Barra, 149 F.2d 489 (CA 2);

Hills v. United States, 97 F.2d 710 (CA 9);

Swisher v. United States, 109 F.2d 1000 (CA 10).

Cases showing the practice of alleging objective falsity in the indictment:

United States v. Gilliland, 312 U.S. 86, 85 L.ed. 598;

Swisher v. United States, 109 F.2d 1000 (CA 10);

United States v. White, 69 F.Supp. 562;

United States v. Hautau, 43 F.Supp. 507.

Congress has persistently distinguished between the crime of perjury (wherein the offense consists of the contradiction between the accused's oath and his belief, see *United States v. Remington*, 191 F.2d 246 (CA 2)) and the crime of filing or presenting false claims or writings such as here. The preservation of this distinction, apparent on the face of the statute in the 1948 recodification, against the background of the case law, manifests a plain Congressional intent to define in the false statement section a crime based on objective falsity of the writing or document.

18 U.S.C.A. Sec. 1621—perjury: “ . . . any material matter which he does not believe to be true . . . ”

18 U.S.C.A. Sec. 1001—false statement: “ . . . any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry . . . ”

Given the “harshness and rigor” of this statute, the court is bound to construe it so that it “will be strictly confined within, the fair meaning of its terms.”

United States v. Moore, 185 F.2d 92, 95 (CA 5);

Hills v. United States, 97 F.2d 710 (CA 9);

United States v. White, 69 F.Supp. 562;

United States v. Rhodes, 30 Fed. 431.

With respect to the fact in issue in this case the court is respectfully directed to the argument of counsel on motion for a direct verdict of not guilty (R. 662-681).

In this argument appellant pointed out that membership in an organization was a matter of meeting formal requirements of membership, citing *United States v. Reimer*, 79 F.2d 315.

Kubilius v. Hawes Unitarian Congregational Church, 322 Mass. 638, 79 N.E.2d 5.

In the case at issue there is no description whatsoever of what is meant by the Communist Party although from the context of the affidavit and the necessary purpose of the affidavit the reference to the Communist Party referred to a particular organization which had been held to be inclined to foment strikes or to advocate the overthrow of the government by force and violence.

The testimony of Harley Mores: Although the crux of the Government's case was the proof of membership

in the particular organization proscribed by the statute on given dates, namely, June 9, 1951, and July 11, 1952, the testimony of the only witness bearing on that issue at all, Harley Mores, was so completely vague and indefinite on the material points in issue as to constitute no evidence at all, or at the very least certainly was so vague as to prevent a proper defense. Excerpts from this witness's testimony are set forth in the Appendix to prove this fact (Appendix, pp. 93-102).

In a case wherein the time the events occurred was of the essence, and in which the stating of the time the events occurred was essential to a defense, the witness Mores was completely unable to state such dates and consequently varied his testimony as to when events occurred from a year to seven years (R. 101, Appendix 93).

Upon the point in issue the witness, Harley Mores, was asked whether or not the defendant was a member of the Communist Party and how he arrived at that conclusion. His answer to this was as follows:

“Well, at first I saw him at Communist Party meetings, and other members introduced me to him, and I became acquainted with him, but at the first few meetings, I don't get their names too quickly. If they introduce me to four or five or six of them, I wouldn't know the names the next day. I have to meet them several times to learn their names, and so I didn't learn his name right away, but I soon got acquainted with him.” (R. 102-103)

The gist of the witness's testimony was solely based upon a conclusion that appellant was at Communist Party meetings and the contention that appellant was a member of the Communist Party was an inference

based upon the further inference that the alleged Communist Party meeting was one at which only members of the Communist Party attended, and thereby clearly assuming the point at issue. The only reference to any other evidence indicating membership in the Communist Party concerned the payment of dues and the witness's testimony in that regard referred to the year 1950 (R. 110). There was no further identification of the time, place, or circumstance of such alleged incident.

The only meetings, testified to by the witness Harley Mores, which were in the period of the indictment were the meeting on December 26, 1952, at which time the witness contended that he was receiving government exhibits 7 and 8 from the defendant and a meeting on January 17, 1953, at which time the witness alleged that he received government exhibit 9 from the defendant.

Government exhibits 7, 8, 9, were pieces of literature which upon direct examination in response to leading questions the witness claimed that he received from the defendant. The following, however, is a quotation from his identifying exhibits 7 and 8.

By Mr. Harris:

“Q Have you *ever* received any literature from the defendant?

A Right now I don't recall.” (R. 116-117)

After having denied that he ever had received any literature from the defendant he then testified that he received exhibits 7 and 8 from the defendant on December 26, 1952. With reference to this meeting on December 26, 1952, the witness was unable to recall the num-

ber that attended the meeting, merely stating that it was a small meeting (R. 116). He stated with respect to exhibits 7 and 8 that the defendant requested him to "read them to some party members." He then went on to state that he was to deliver the literature to "the same house we had the committee at and to instruct him that we would have a meeting at his house in a week or two." The transcript reads as follows:

"Q We were to have a meeting, what do you mean?

A The Communist Party and Fisher and I were to be there." (R. 137)

The witness then was asked to give a date of the next meeting to which he replied, "No, I don't believe I can." However, immediately upon being shown government exhibit 9 he gave the date of the meeting as January 17, 1953 (R. 139).

It should be noticed also that immediately after the witness Mores identified exhibits 7 and 8 he was asked by counsel for the defendant, "Now, do I understand your testimony to be correct, that Mr. Fisher gave you these two exhibits for identification on December 26, 1952?" and the witness merely answered, "I *believe* so" (R. 119).

He then stated that he could remember only one other meeting after that at which the defendant had attended and stated that this meeting was held one week before the trial at which the witness had testified in May of 1953 (R. 140-141). Counsel for the Government then asked the witness directly with respect to that meeting, "Of those 7 were there any present who were not Com-

munist Party members?" and the witness replied, "I couldn't say it that way. There was one present that they told me hadn't belonged but her dues had been paid. I collected her dues for at least a year so I couldn't say she didn't belong. Nobody had a card."

With respect to that meeting the witness was asked as to what was discussed with the defendant at that meeting and he replied, "Well, there was lots of discussion went on but I don't recall just exactly."

In each of the above instances, such constituting the only testimony at all connecting the defendant in any way with alleged Communist meetings it is obvious that the witness's description of the meeting as a Communist meeting was a matter of opinion based upon hearsay. This is further shown by his testimony with respect to one of the meetings referred to above in which he states, "There was one present that they told me hadn't belonged." This clearly indicates that his testimony is based upon what he was told.

Upon cross-examination the witness was unable to repeat any of his testimony on direct. With reference to almost every question attempting to place the date to a meeting the witness would answer, "I don't know." Upon direct he testified that he rode in the defendant's car (R. 109), but on cross he testified, "I might have, I don't know" (R. 271).

Time and space do not permit detailing the numerous contradictions. The testimony of Harley Mores is both inconsistent with itself, and at total variance with the other witnesses. Two such inconsistencies may be mentioned as illustrative.

The witness Mores volunteered the flat denial that he had ever called any government agent on the telephone in connection with his alleged undercover work (R. 243, 249). His wife on the other hand testified that her husband called the F.B.I. a "considerable number of times" on the telephone (R. 629, Appendix p. 88).

The second illustration is more than an inconsistency in that it is an example of the situation prevailing throughout the trial with respect to the date that events were alleged to have taken place. The witness Mores testified concerning an enlarged District Committee meeting at the Frye Hotel on December, 1949 (R. 107). The witness Harper referred to the meeting at the Frye Hotel as having taken place on the first of January, 1949 (R. 409). The date of the meeting is thus placed at almost a year apart.

The basic and conclusive fact, however, is that the *only meetings testified to by any witness during the period of the indictment* were alleged to have taken place on December 26, 1952 (R. 114,115,116), another meeting a short while after that at some member's home near Sultan (R. 132) and a third meeting, which was admittedly not limited to members of the Communist Party in May of 1953 (R. 134). This constitutes the only relevant testimony bearing directly on the issue involved by any witness, and this testimony might conceivably be considered relevant on the issue of whether or not appellant signed a false affidavit on June 5, 1953, however, with respect to that date, Counts V and VI, the jury acquitted the appellant.

In view of the above it follows, *a fortiori*, that the

evidence was insufficient if the rule as to quantum of proof in a perjury case had been applied (See argument in Point IV (*supra*, p. 44)).

For the reasons stated, including all of the reasons set forth in the Statement of Points, it is respectfully submitted that the judgment of the court below should be reversed.

Dated July 7, 1955, Seattle, Washington.

R. MAX ETTER,

C. T. HATTEN,

Counsel for Appellant.

APPENDIX

1. INDICTMENT

COUNT I

That on or about June 29, 1951, in the Northern Division of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Non-Communist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was not then and there a member of the Communist Party whereas, as the said AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there a member of the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

COUNT II

That on or about June 29, 1951, in the Northern Division of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and

in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Non-Communist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was not then and there affiliated with the Communist Party, whereas, as the said AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there affiliated with the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

COUNT III

That on or about July 11, 1952, in the Northern Division of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Non-Communist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A.

Fisher, was not then and there a member of the Communist Party whereas, as the said AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there a member of the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

COUNT IV

That on or about July 11, 1952, in the Northern Division of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Non-Communist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was not then and there affiliated with the Communist Party, whereas, as the said AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there affiliated with the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

COUNT V

That on or about June 5, 1953, in the Northern Divi-

sion of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Non-Communist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there a member of the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

COUNT VI

That on or about June 5, 1953, in the Northern Division of the Western District of Washington, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, and in accordance with Section 9(h) of the Labor Management Relations Act of 1947, did unlawfully, wilfully and knowingly use and file, and cause to be used and filed with the said National Labor Relations Board a false writing and document, namely, an "Affidavit of Noncommunist Union Officer" (Form NLRB-1081) knowing the same to contain a false, fictitious and fraudulent statement and representation, to-wit, that

he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was not then and there affiliated with the Communist Party, whereas, as the said AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, well knew, he, AVALO ALLISON FISHER, alias Al Fisher, alias A. A. Fisher, was then and there affiliated with the Communist Party.

All in violation of Title 18, U.S.C., Section 1001.

A TRUE BILL

Foreman

CHARLES P. MORIARTY

United States Attorney

RICHARD D. HARRIS

Assistant United States Attorney

2. TESTIMONY OF THOMAS R. DURHAM (R77-78)

DIRECT EXAMINATION

THE CLERK: Will you state your full name and spell your last name, please?

THE WITNESS: Thomas R. Durham, D-u-r-h-a-m (spelling).

By MR. HARRIS:

Q For all of us, will you repeat it once again, your name?

A Thomas R. Durham.

Q Your address, Mr. Durham?

A 7101½ North Tenth Street, Tacoma, Washington.

Q And your present occupation?

A Deputy Sheriff, Pierce County, Washington.

Q And prior to that time, what was your occupation?

A Police Patrolman for the City of Sumner, Washington.

A And, in that capacity, do you know the witness that just preceded you, Mr. Durham?

A I do.

Q And were you a Police Patrolman in June, 1950?

A I was.

Q And on that date, did you have occasion during that period—did you have occasion to see the Defendant in this case?

A I did.

Q And do you recall what day that was?

A It was in the early morning hours of June 30, 1950.

Q And you are sure of the date, is that correct?

A Yes.

Q Did you have—did you notice anything unusual about anything that was in his possession or in his automobile?

A I recall the unusual amount of the white pamphlets described by the previous witness, several of them, I would estimate there were 100, well over 100 of the white pamphlets.

MR. HARRIS: I think that is all. Your witness.

3. DIRECT TESTIMONY OF MAZIE MORES:

THE CLERK: Will you state your full name, and spell you last name, please?

THE WITNESS: Mazie Mores.

By Mr. Harris:

Q Would you state your name, please?

A Mazie Mores.

Q And what is your address, Mrs. Mores?

A Gold Bar.

Q Have you ever been a witness in a case before?

A I never have.

Q Are you the wife of Mr. Harley Mores?

A I am.

Q Mrs. Mores, have you ever been a member of the Communist Party?

A I have.

Q And when did you first become a member?

A Oh, I would judge around 1942.

Q And did you discontinue your membership when your husband took the stand, last year?

A I did.

Q Mrs. Mores, do you know the defendant in this case, Mr. Fisher?

A I do.

Q Do you see him here in the courtroom?

A I do.

Q Would you kindly indicate from there, by pointing where he is located?

A (Witness points to defendant.)

Q What color suit does he have?

A Blue.

MR. ETTER: This is Mr. Fisher. We will stipulate this is Mr. Fisher.

MR. HARRIS: Thank you, Counsel.

By Mr. Harris:

Q Have you ever seen Mr. Fisher at any Communist Party meetings?

A I have.

Q Now, did you ever have a conversation with Mr.

Fisher concerning any matters relating to the Communist Party?

MR. ETTER: I will object to that, unless you put a time and a place.

MR. HARRIS: I am trying to establish it.

THE COURT: It is a preliminary question?

MR. HARRIS: I am trying to establish that now, if your Honor please.

THE COURT: I understand. Objection overruled.

A I have.

By MR. HARRIS:

Q Have you ever had a conversation at your home with him?

A Yes, sir.

Q Do you know when it was that you had this conversation?

A No, I don't know the specific date, but it was around about three or four years ago.

Q Do you know where it was?

A Right in our living room.

Q Who else besides yourself and Mr. Fisher was present?

A My husband, Harley Mores.

Q What was said at that conversation?

A Well, he said he had been elected to some kind of office, but I couldn't say—

MR. ETTER (interposing): I will object to any conversation, if the best we can get is three or four years before.

MR. HARRIS: I think the conversation might assist in establishing that time. The dates don't always do that.

THE COURT: Your best recollection, Mrs. Mores, is three or four years ago?

THE WITNESS: Yes.

THE COURT: Can you fix a date closer, do you think?

THE WITNESS: Well, I don't hardly think I could.

THE COURT: That is your best—

THE WITNESS (Interposing): That would be my best ability, three or four years ago, because I know my little girl was just very small. That is what I was going by.

By Mr. Harris:

Q And what was that conversation, Mrs. Mores?

A Well, he said he had been elected to some kind of an office, and he would have to sign a non-Communist Affidavit, and he was asking advice of my husband.

Q And who was that, that was asking this advice?

A Mr. Fisher.

Q Now, Mrs. Mores, prior to that time, had you ever seen the defendant at any Communist Party meetings?

A I had.

Q After that time, did you see him at any Communist Party meetings?

A Well, not for some time. I know in December, the 26th, right after Christmas of 1952, they wanted to have a meeting at my place Christmas Eve, but I were expecting a bunch from east of the mountains, and I didn't want to have the meeting, and they said they would have it the next day, after Christmas, and he was there.

MR. ETTER: I move that all that testimony be stricken. It refers to 'They said this' and 'They said that,' and 'They said the other thing.'

Is there any identification or any connection at all shown with the defendant, any conversation that this witness testified to?

THE COURT: This testimony, I take it, is not offered

as to the truth of anything that may have been said. It relates to fixing—

MR. HARRIS (Interposing): —a date.

THE COURT (Continuing): —the date of the meeting?

MR. HARRIS: That is all.

THE COURT: So that the Court will advise the jury that the testimony of this witness wherein she says they may have said something, that testimony is not to be considered as a statement of Mrs. Mores, is not to be considered as establishing the truth in any way of what was said, the purpose being to establish a date, rather than to establish what was said, at this time, at least.

MR. ETTER: I further object unless there is a connection shown between the defendant and 'they.' How can defendant be bound by what 'they' say?

THE COURT: This is a preliminary question, and not to be considered at all as to anything binding upon the defendant in any respect in regard to anything that may have been said, up to this point, as a result of the witness's testimony.

By Mr. Harris:

Q Mrs. Mores, now, when did the—if it did, when did the meeting actually take place in your home in December, 1952; on what day?

A The 26th day of December.

Q Was the defendant present at that meeting?

A He was.

Q What kind of a meeting was it?

A It was a Communist Party meeting.

Q Was he present at any other meetings after that date, that you recall?

A Well, I recall of one, and that was just about four days before the Smith Act trial, four or five days, be-

cause I knew my husband were going to be on the stand at that time when I were in the meeting.

Q And you say—was the defendant there at that meeting?

A Mr. Fisher?

Q Yes, Mr. Fisher.

A He was.

Q Where was this meeting held?

A It was held at the Art Halls, whether you call it the Cheney Place.

Q How many people were present?

A Oh, they were maybe six, seven—five, six, seven, in there.

Q Was your husband present at that meeting?

A He was.

Q And you say the defendant was present?

A He was.

Q What, if anything, did he say, the defendant, at that meeting?

A Well, he said as many people as could possibly get out should go down to the trial and make a showing.

Q What else did he say, if anything?

A Well, he was trying to get up all the money that he could get to fight the Smith Act trial.

Q Anything else that you recall? Was there anything said by the defendant concerning witnesses in the trial?

MR. ETTER: These questions, of course, are all leading.

THE COURT: Objection sustained.

MR. HARRIS: If your Honor please—

MR. ETTER (Interposing): Counsel is testifying.

MR. HARRIS: No, Counsel is not yet testifying. If your Honor please, I believe I have exhausted the witness's

recollection of that meeting, and I am asking her now if she recalls.

THE COURT: You might ask her again, so that that is conclusively brought forth. I don't think it is conclusively shown yet as to exhausting her memory.

MR. HARRIS: Excuse me, your Honor.

By Mr. Harris:

Q Mrs. Mores, was anything else said by the defendant at that meeting, the one that you—

A (Interposing) Well, I don't know. They were talking about some stoolpigeons, and things of that sort, you know. I didn't pay much attention, because I were awfully nervous, you know, because I just figured if they knew my husband was going to be on the stand, why, we would be just in bad.

Q Did the defendant participate in that conversation?

A He did.

MR. HARRIS: Your witness.

Cross-Examination

By MR. ETTER:

Q When did you first meet Mr. Fisher, Mrs. Mores?

A Oh, I would judge somewhere around 1946.

Q About 1946?

A I would judge it would be around close to then.

Q Do you know Mrs. Fisher?

A I do.

Q Do you know the children?

A No.

Q Have you been in the Fisher home?

A No.

Q You haven't, and you say Mr. Fisher has been at your home?

A He has.

Q And what was the first date that you recall? You said three or four years ago.

A That was one time that he had been in my home, before that one specific time.

Q You don't recall the other meeting, is that it?

A I don't recall the dates of them, but I have had several of them in my home.

Q Mr. Fisher had been to your home on business of the union? Had he not been there a number of times on the business of the union?

A Not to my recollection, because I didn't belong to no union at all. All I knew him to be there for was the Communists.

Q Your husband belonged to a union, did he not?

A He did.

Q Did he ever stop and talk to your husband about any union business?

A Not as I ever knew of, because he would always talk to him down at the hall where they had the union meetings.

Q Did you used to attend Communist Party meetings away from your home, too?

A I have.

Q You have? Prior to the date that Mr. Fisher came to your house?

A Yes.

Q Is that correct? And the date, I think you said, was three or four years ago, the first one that you recall?

A Yes.

Q Is that right, and then you said there was another. How many people were at that first meeting, do you recall, three or four years ago?

A There were only the three of us at this one time when I know he come down there.

He come in his work clothes, coming home from work.

Q There were only three there?

A Only three, him and myself and my husband.

Q And you had a meeting?

A No, we didn't have no meeting. He just come and told my husband he had been elected to some office and he would have to sign a non-Communist Affidavit, and he wanted to know what to do about it, so my husband referred him to the higher-ups in Everett.

Q Your husband—what you are saying is, Mr. Fisher came to ask your husband's advice?

A Yes.

Q The man who has testified here?

A Yes.

Q And that was the extent of that meeting?

A Yes.

Q And the next time that you recall that he came to your house was December 26th?

A Yes.

Q Of 1952?

A Yes.

Q Is that correct? You don't recall that he had been at your home at any time prior to—I mean, after this three or four years ago episode, and December, 1952?

A No, I don't recall.

Q I beg pardon?

A No, I don't recall of him being there.

Q And this time, December 26th, how many people did you say were there at your place?

A I don't think I said, but there were quite a few there at that time, at the last meeting. The last meet-

ing, there were only four or five, but this 26th, I think there must have been around eight or ten people at that meeting.

Q Around eight or ten people at that meeting?

A Yes.

Q People that you knew?

A Yes, people that I knew.

Q And Mr. Fisher was there?

A Yes.

Q And that was in your home?

A That was in my home.

Q And how long did the meeting last?

A Oh, it probably lasted until 10:30 or 11:00 o'clock that night.

Q It lasted until 10:30 or 11:00 o'clock that night?

A Yes.

Q That evening, I see. Did you say that you joined the Communist Party in 1942?

A Yes, the last time. The first time I joined it, I joined it in 1935.

Q In 1935?

A Yes.

Q I see.

A And we only remained in it a short while, because we kind of got in on the inside, and we figured out what it was, and we didn't want no part of it ourselves so we dropped out.

A I see.

A And then in 1942, why we decided then to work for the Government, and I and my husband came down to this building and seen them about it. First, there was one guy came up and had a talk with us, and so we didn't know whether he was from the Bureau or not, so we came down to check up on him.

Q You say that you had joined in 1935?

A I think it was in 1935.

Q Both you and Mr. Mores?

A Yes.

Q And where was that? Here in this State?

A Yes.

Q And you left in 1942?

A No, we only belonged to the Community Party in 1935 just a short while. Probably less than a year, and then we dropped out, and we were going to quit it cold, and not have anything to do with it, because we didn't want anything to do with it.

Q This was in 1935?

A Just to find out what it was. We didn't know. They put up a good line to us, and we went in to find out.

Q And you dropped right out?

A And we found out what it was, so we just dropped out.

Q And that was the last you heard of it until 1942?

A 1942, yes.

Q I see; when the Agent came to your place?

A Yes.

Q And he talked with you, did he?

A He first talked to my husband, and my husband—and I went down to the barn about my business, because I figured it was some logger with some timber, because he was working the woods at that time, and I went on about my business, and paid no attention, and he came down and told me it was for me, too.

Q Your husband came down?

A My husband, and I went up to the house and had a talk over, three of us together.

Q Where did you have the discussion?

A Right in my home.

Q At your house?

A Yes.

Q Not down at the barn?

A No.

Q. Or out in the front yard?

A No, right in our front room.

Q What was that discussion? Can you tell us?

A Well, he just asked us, had we been in the Party, and we told him "yes, we had," and he said he would like to get some information on the inside and he asked if we would join and pick it up, and my husband said "If you think it will do the Country any good, I will, if she is willing. I have got two brothers over there fighting today, and I feel it is our duty to do a little something."

Q That was—did he say how he had known, how this Agent had known you and Mr. Mores had been in the Communist Party before?

A No, he didn't.

Q Did you inquire?

A No.

Q Or how he found out, or anything like that?

A No.

Q And was there some agreement that you reached at that time?

A No.

MR. HARRIS: I am going to object, your Honor. It is improper cross-examination. I don't think I went into that.

MR. ETTER: I don't think, if she admits she is a member of the Communist Party, and is testifying to meetings, that I am limited in the cross-examination to a

specific instance. I have a right to inquire into the association.

THE COURT: Yes, I think I should overrule the objection. Is there a pending question?

MR. ETTER: I don't believe so.

MR. HARRIS: I thought there was a question about conversation with an F.B.I. Agent.

THE COURT: I think the last question was answered.

MR. HARRIS: All right.

By MR. ETTER:

Q Was there any condition discussed upon the basis that you and your husband would rejoin the Communist Party at that time, that first discussion you had with the gentleman at your house?

A I don't get your question.

Q Did you have any discussion about what you were supposed to do, or any conditions?

A No.

Q Well, did your husband say anything about—to the Agent, that he would find out what he could about the Communist Party, and that that was all?

A Yes, that is all.

Q Did he say to him that if a union man would blow up a bridge, he wouldn't tell the F.B.I. man about it? Did he say that to him?

A No.

Q I beg pardon?

A I don't think he did. I didn't hear it, if he did.

Q Did you ever hear him say that?

A No.

Q After that meeting, you say you came down to Seattle. Did you come down to Seattle?

A I have been to Seattle to Communist Party meetings, if that is what you are getting at.

Q No, after the meeting with the gentleman from the Federal Bureau of Investigation?

A Oh yes, we came to Seattle right to this building, and checked up on him to find out if he were from the Federal Bureau.

Q How soon was it after that meeting?

A Well, it was in less than a week.

Q Less than a week?

A Yes.

Q Did you see him,—the same fellow—down here, that had been up to see you?

A No.

Q You did not?

A No. We went to the highest guy down here, and I think his name were Clark, at that time.

Q And you went back up to your home?

A Yes.

Q And had another visit from an Agent?

A We had several visits. We never had no more until after we joined the Party.

After we came down and talked to the guy in charge down here, we went back up and waited until they came and asked us to join the Party back, and then we joined the Party back.

Q How long was that after your visit here?

A About three weeks, someone came along and asked us to join the Party back.

Q Was it the same Agent?

A No, it was some Party member.

Q I beg pardon.

A Some Party member.

Q Some Party member?

A Yes.

Q And did you join then?

A We joined.

Q I see.

A And after we joined, my husband got connection with them some way. I don't remember whether he called him up, or whether he got in connection with him, but we had joined the Party back, and then he come up and he had a visit.

Q Your husband got in contact with them?

A He got in contact with them after we joined the Party.

Q Did he tell you that?

A Yes.

Q He didn't tell you how he got in contact?

A No, I don't remember, because he has a lot of phone calls, and he has a lot of different ones.

Q Did he phone the F.B.I. a considerable number of times?

A He has.

Q He has; and the next time the Agent came up, where did you see him?

A We usually met him in a car.

Q I mean the next time that you saw the Agent from the Federal Bureau of Investigation after you joined the Communist Party.

A He came to my house.

Q He came to your house?

A Yes.

Q All right.

A And my husband wasn't home; he was working at Granite Falls.

Q He was what?

A Working at Granite Falls, and he didn't get to see

him, and he made two or three trips over to Granite Falls, before he could find my husband, because he were out in the woods, working.

Q He came there, and your husband was in Granite Falls?

A Yes, the Agent came to my house, in Gold Bar, and to Granite Falls.

Q Did he find your husband that day?

A Not the first day. He made about three trips there before he found him. He wasn't used to the woods, and didn't know how to get around in the woods.

Q Do you know how many days it was after that that your husband told you he seen the Agent again?

A I don't know. He made a date with my husband to be home on a Saturday, I think; Saturday evening; we seen him at the house, at that time, yes.

Q All right, and where did you have your discussion with him at that time?

A Well, probably sitting out in the car. We have had so many different discussions with him.

Q When did you make a definite arrangement about what you would do and how your expenses or your pay would be taken care of?

A We didn't have no—

Q (Interposing) I beg pardon?

A We didn't have no agreement.

THE COURT: When you say "we," who are you talking about?

THE WITNESS: I and my husband.

By MR. ETTER:

Q Did you have any meeting where there was any arrangement discussed for expenses, or otherwise?

A We didn't know we were going to get a penny out

of it until one time he came up and gave us fifteen dollars, and said, "That is to help pay expenses."

Q I see; when was that, do you remember?

A Oh, probably about one month after we got in touch with them after we joined the Party.

Q Was that in 1942?

A I judge it was in 1942.

Q I beg your pardon?

A I judge it would have been in 1942. That is when we joined back.

Q And you had no arrangement about expenses up to that time?

A No, we never even talked them over with them at all, because we figured we was doing a duty to our Country.

Q And he came up and gave you fifteen dollars?

A He came up and gave us fifteen dollars, the first time.

Q All right; did you give him a receipt?

A Yes, we always signed a receipt.

Q You always signed a receipt?

A Yes, I and my husband, both.

Q And how long was it after he gave you the fifteen dollars that you received any more money?

A About one month.

Q About one month?

A Yes, we received fifteen dollars more in about a month.

Q You received about fifteen dollars more in about a month?

A Yes.

Q And was that how much you received each month, about fifteen dollars?

A We did, for quite a little while, and then they raised it up to \$30 and then they raised it up to probably \$40 or \$50, and then we got up as high as \$175. I think we got that for about three or four months' work before my husband went on the stand, because he were making lots of trips down here to Seattle.

Q Were these payments made regularly per month?

A Yes.

Q Pardon?

A Yes.

Q And that is in 1942 or 1943?

A Yes.

Q How long were you paid fifteen dollars a month regularly, do you remember?

A I couldn't say, but that was some time. We were paid fifteen dollars for over a year, probably.

Q And how much then, did you get, thirty dollars?

A Yes.

Q And do you recall how long you received thirty dollars?

A No, I don't recall that.

Q And the next amount?

A I don't know. They kept raising it on up until—

Q (Interposing) They kept raising it?

A Yes, as he was sent farther off to meetings and more of them they would raise it a little more for expenses, because sometimes I had to hire somebody to help me with the work at home.

Q And he would make reports?

A Yes.

Q Would you help him with the reports?

A Sometimes I would, if I happened to comment, and lots of times I would because I didn't know if he would make it back or not.

Q Who paid for the long distance calls he would make?

A I don't know; I was never in the phone booth with him; because he used the pay phone in Monroe.

Q He used the pay phone in Monroe?

A Yes.

Q You don't know who paid for it?

A I know he paid for it that one time. But the other calls, I don't know whether he paid, or they paid, but I know that one specific time when we drove to Monroe to make a phone call, that he paid.

(Whereupon, there was a brief pause.)

MR. ETTER: Your Honor, may I confer with counsel a moment?

THE COURT: You may.

(Whereupon, counsel for defendant conferred at counsel table, and after a brief pause, the following proceedings were then had, to-wit:)

MR. ETTER: One or two questions, Mrs. Mores.

By MR. ETTER:

Q Were you subpoenaed here today?

A No.

Q Did you receive a subpoena?

A No.

Q When were you asked to come down today?

A I were asked, I judge, about 10:30.

Q 10:30 when?

A Today.

Q Today?

A Yes.

Q To come down?

A Yes.

Q You weren't—hadn't been asked at any time before?

A No, an agent told me this morning that I might be called down today.

Q When?

A He told me that about a quarter after six this morning.

Q So that you were called about 10:30 and have been here since?

A Yes, about 10:30.

MR. ETTER: Thank you, Mrs. Mores. That is all.

4. EXCERPTS OF TESTIMONY OF HARLEY MORES

By MR. HARRIS:

Q When did you first make his [Appellants] acquaintanceship?

A Well, that I am not too sure of, but I believe it was in 1935 or 1936.

Q 1935?

A Wait a minute, wait a minute, now.

(Whereupon, there was a brief pause.)

A (Continuing) I am not too certain on that. It might have been 1937. I ain't too sure.

Q Was it before the time you were working in the shipyards, or after the time you were working in the shipyards in Everett?

A It was after that, I believe.

Q And when were you working in the shipyards in Everett?

A 1943.

Q 1943 to when?

A It might have been 1946 I run across him, 1947.

Q You have said previously it might have been '37. Did you mean '47 or '37?

A Well, it could have been '47. I am not too sure on that date I recollect. (R. 101)

* * * * *

Q How did you join the Communist Party?

A Well, there were members of the Communist Party that asked me to join in, and handed me literature and asked me time and again to join and to attend open meetings, which I did. They would have an open meeting once in a while, to try to get new members in. I attended some of them, and I joined.

Q You say they had an open meeting; what do you mean, open to the public?

A What?

Q Open to the public?

A No, I wouldn't say that.

Q Well, an open meeting—

A (Interposing) Open meeting to the ones they invited. If someone came they didn't want, they wouldn't hold a meeting, I know that.

Q I see, that was in 1934?

A Well, I ain't sure what year it was.

Q When was it that you—these people handed you literature and talked to you about joining the Communist Party? Do you remember when that was?

A Well, no, I don't. Before I joined, for a year or two, I had had literature handed to me, and I was acquainted with several of them.

Q You had had literature handed to you?

A Yes, I did.

Q For a year or so before?

A Oh, yes, one or two years, probably.

Q Pardon?

A One or more, probably.

Q Did I understand you to say on my cross-examination a question or two ago, that members, some members, of the Union gave you Communist Literature?

A In later years, yes.

Q I mean before you joined the Communist Party?

A I don't recall saying that.

Q I beg your pardon?

A I don't recall saying that.

Q I don't know whether you did or not. As a matter of fact, did any of the Union members give you Communist literature before you joined the Party?

A I don't know whether they did or not.

Q I beg your pardon?

A I don't recollect.

Q Whether they did or not?

A No, I don't.

Q But I gather that you had been given this literature for the year, did you say, or two, before you joined the Party?

A I believe so. (R. 179-181)

* * * * *

Re: Memory of Dues

Q Isn't it a fact now, Mr. Mores, and I want you to think about this, that from 1946 a Communist Party member with an income of over sixty dollars paid two dollars a month dues; a member of the Communist Party who had an income of twenty-five to sixty dollars a month paid one dollar dues; a Communist Party member who had an income of less than twenty-five dollars paid thirty-five cents per month dues; and an unemployed member of the Party paid ten cents?

A I don't recollect it that way, I don't think. (R 234-235)

* * * * *

Re: Fisher's Car and Meeting Fisher

Q On your direct, your first answer was you thought you met him in '35 or '36, and you said you weren't certain, that it might have been in '37, and you said you might have met him in '47; and now, you say you might have met him in '46?

A '46 or '47.

Q What is your answer now, what year, roughly?

A Either '46 or '47.

Q It was either '46—

A (Interposing) I think that is when I met him.

Q (Continuing) —or 1947, is that correct? You said likewise that you had ridden a number of times in Mr. Fisher's car?

A No, I don't believe I did.

Q I beg pardon?

A I don't believe I did.

Q Did you ever ride in Mr. Fisher's car?

A Oh, yes, I have. The time I was thinking of, I was riding in another man's car, and he rode with us. I thought that is what you were talking about.

Q You never did ride in Mr. Fisher's automobile?

A Well, I was just a studying, since you mentioned it, whether I did or not. I might have. I don't know.

Q Did Mr. Fisher ever ride in your car?

A I can't answer that one, either. I don't know.

Q You don't know?

A No. The meetings were all close together up there.

We might have took both cars or he might have went with me or I went with him. I don't remember.

Q At the time you went to a meeting you said you went in another man's car?

A That is right, another party's car.

Q Both you and Mr. Fisher?

A Yes, that is right.

Q I think you — do you know when Mr. Fisher joined your Local; that is, the I.W.A. Local, at Sultan? I guess it was the Sultan Local?

A I do not.

Q Did you attend the Union meetings?

A Oh, I attend part of them. We don't attend all the meetings.

Q Well, do you recall whether you saw Mr. Fisher at the Union meetings?

A Sure, I have saw him at Union meetings.

Q I beg pardon?

Q And can you tell us when you first saw him at a union meeting?

A No, I don't believe I can.

Q Can you remember, or can you tell me, the last Union meeting that you attended where Mr. Fisher was present? That is, of you recollection?

A No, I couldn't tell you that date, either. (R. 270-272)

* * * * *

Re: When Saw Fisher:

Q Do you know—you met Mr. Fisher, I think you said, in '46 or '47, is that correct?

A Well, I believe it is the best of my recollection that one of them years I met him.

Q One of those years?

A Yes.

Q You saw him, I gather from your testimony, in '48, '49 and '50; isn't that correct?

A Well, I recollect seeing him in 1949, and I had seen him the previous times before that at various and different places. I saw him in 1949 and '50. I didn't see him much in '50, '51 and '52.

Q You didn't see him much?

A Let's see, 1949, in 1949, about January 1st, I believe it was, he come to my place, and I don't recollect seeing him too much then for awhile.

Q I wish you would speak louder, Mr. Mores.

A In '49, January 1st, I believe, he come to my house, and it seems like I didn't see him very much for about a year.

Q You say that in January of '49—

A (Interposing) I am not too sure on that date. I think it was in there.

Q He came to your house?

A Yes.

Q Had you seen him in—then, I gather your testimony is you didn't see much of him in 1950 and '51?

A About one year, I didn't see much of him.

Q Would that be from '49 until '50?

A Yes, I believe it was.

Q You didn't see much of him?

A No.

Q Is that right?

A Yes.

Q Well, did you see him in 1950, the year 1950?

A It might have been '52, in September, when I seen him last. I ain't sure.

Q It might have been '52? As a matter of fact, from '49 until '52, you didn't see Fisher, did you?

A I don't recollect whether I saw him much in that time or not.

Q Your testimony was it was December 26th, of 1952, that you saw the Defendant Fisher?

A January, wasn't it?

Q You can state January or December; I thought you said December.

A Wait a minute now. Which year are you talking about?

Q 1952.

A That was September.

Q September?

A In 1952, I think it was September.

Q I don't want to confuse you, Mr. Mores.

A I know that.

Q I think you testified you saw Mr. Fisher on December 26th, at your house, of 1952.

A Wait a minute, December 26th?

Q Of 1952; I think that was your testimony.

(Whereupon, there was a brief pause.)

A *I don't recall those dates exactly*, but you have literature with those dates on them that I turned in here.

Q Whatever it may be, whether December of '52 or September of '52, after he came to your house in 1949 you didn't see Mr. Fisher again around that country until '52, isn't that correct?

A I wouldn't say I just actually saw him, but he wasn't so plentiful around there as he was before.

Q That is right; did you know what he was doing then from '49 on up until at least through '50?

A. Why, sure; I seen him in our Local Union meetings, but he didn't come to my house.

Q I see. And you saw him at Local Union meetings during that time?

A Occasionally. I didn't attend all of them. I would see him once in a while.

Q Do you know whether he had some other position here in Seattle or not?

A In Seattle?

Q Yes.

A No, I didn't. Wait a minute. What way, a job?

Q Did he have any title, or an officer of some group, or anything like that, here in Seattle?

A No, if he was an officer of some group here, I didn't know that.

Q Well, did you know whether he was — did you know whether he had any occupation than working as a woodsman or as a man in the woods in '46; did you know whether he had any position or office that he held here in the City of Seattle?

A No, I didn't.

Q Or did you know that in 1947 whether he held an office or position here in the City of Seattle?

A No.

Q Or '48?

A (Witness nodded in the negative.)

Q Or '49?

A No.

Q Or any time beyond, isn't that correct?

A I don't recall it. (R. 273-277)

* * * * *

**Re: Knowledge and Memory of Fisher and Taft-Hartley
Affidavit:**

Q Now, isn't it a fact, Mr. Mores, that in '46, '47, '48 and '49, that Mr. Fisher was the Secretary-Treasurer of the Washington State CIO Council here in the City of Seattle?

A I don't know.

Q I beg pardon?

A I don't know.

Q You don't know, but you knew him through those years, isn't that correct?

A I believe I did.

Q You believe you did, and didn't you know with respect to those years — did you know whether Mr. Fisher was or had been the Secretary of the State CIO Council located here in the City of Seattle?

MR. HARRIS: Your Honor, I will object to that as repetitious. I think I objected last Wednesday because of the form, and it was not in evidence, and Counsel reframed the question, and this witness said he didn't know whether he was or not.

MR. ETTER: He didn't know in that year, not that he didn't know at all.

THE COURT: I will overrule the objection.

Q (Continuing) I might put it this way: Do you know whether or not Mr. Fisher was at any time Secretary of the Washington State CIO Council?

A I did not.

Q You do not; you said that you talked to Mr. Fisher about his executing a Taft-Hartley affidavit; do you remember?

A I did.

Q When was that?

A *I don't recollect that date this morning, either.* (R. 298-299)

* * * * *

Identification of Exhibits 7, 8, and 9 by word "Bear":

Q Mr. Mores, Plaintiff's Exhibit No. 7, there is some writing at the top of the exhibit, and I would like to have you look at it and tell me when you put that writing on the exhibit, when you wrote on it. Let's put it that way.

A Well, I put this on here on December 26, 1952.

Q December 26, 1952?

A Yes.

Q All right; now, the word over here, "Bear"?

A That wasn't put on the same time, either.

Q That wasn't put on the same time either; when was "Bear" put on?

A That was put on at the time I handed it to the Agent.

Q At the time you handed it to the Agent, I see; what was the reason, do you recall the reason, that you gave on your direct examination, for writing the word "Bear" on these two exhibits?

A That was a name that was arrived at instead of using my own name.

Q No, but do you remember the reason that you gave the Jury for putting the word "Bear" on these two exhibits; do you remember what you told Mr. Harris and the Jury?

A The reason was in case it was found by someone else, they wouldn't know who had the paper.

Q That is right; they wouldn't know who was holding onto it, is that the idea?

A That is right.

Q What do you mean, "found by somebody else"? You mean intercepted, or something like that, before you could turn it over to the F.B.I.?

A Well, I don't quite get the meaning of your question.

Q Well, you say you put that on so that, as I gathered it, so that if somebody found this paper, they wouldn't know who had it, is that right?

A That is right.

Q They wouldn't know who had it, and when would you put that word "Bear" on there?

A When I got ready to hand it to an Agent I usually wrote that on.

Q When you handed it to an Agent, you wrote that on; and that was so that it couldn't be identified?

A That is right.

Q But the same time you got it, you wrote on it, "Received from Al Fisher at Harley Mores," and then had your wife put her name on it, is that the idea; is that what you want us to believe?

A I didn't quite catch that reading there.

Q Well, you stated that very soon after, as quickly as it was expedient, I assume, you put this writing on the top, "Received from Al Fisher at Harley Mores, December, 1952"; that shortly after you would write that on and put your name on there and your wife's name?

A I didn't say her name was put on there at that time.

Q This was "Received from Al Fisher at Harley Mores"?

A I believe it was put on there at the time.

Q But then you wrote "Bear" on there to hide your identity, is that correct?

A That was the idea.

Q And you put it on after you made this inscription?

A That is right.

Q So that if the paper had been found or picked up after you wrote this, and before you put "Bear" on there, all it would have on it was, "Received from Al Fisher at Harley Mores," isn't that right?

A That is all.

Q And in your handwriting?

A It would be. (R. 299-303)

* * * * *

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HONORABLE WILLIAM J. LINDBERG, *Judge*

BRIEF OF APPELLEE

FILED

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BRIEF OF APPELLEE

QUESTIONS PRESENTED

1. Whether the materiality of the false statements appellant was charged with having made was adequately alleged in the indictment, and whether in any event any prejudice arose or now appears from any technical deficiency in the indictment in this respect.

2. Whether the second and fourth counts of the indictment were too vague to support a conviction

thereunder because they charged that appellant was "affiliated" with the Communist Party, without defining the term or setting forth the acts which constituted such affiliation.

3. Whether it was proper to allege the false statement on membership in one count and the false statement on affiliation in another count when both statements were contained in the same affidavit.

4. Whether the trial court properly admitted the testimony of the witness Harper regarding appellant's Communist Party membership prior to the dates of the affidavits.

5. Whether the ruling of the trial court which permitted the witness Harper to explain his answer to a question was proper.

6. Whether the trial court properly excluded—

(a) evidence offered as impeachment evidence which was merely cumulative of evidence already introduced;

(b) the testimony of the prosecutor which was offered as impeachment evidence on the basis of an alleged prior inconsistent statement by the witness Harper when there was no evidence of any prior inconsistent statement;

(c) evidence of former testimony of the witness Harper, offered as impeachment evidence, on a collateral matter having no bearing on any material issue of this case.

7. Whether the trial judge properly refused to give the "two-witness" perjury instruction, in view of the facts that (1) this was not a prosecution for perjury but for making "false statements," (2) the non-Communist affidavit provision of the pertinent statute specifically directs that prosecution for false statements be brought under the "false statements" statute, and (3) the gist of the offense is not the false swearing but the filing of the false affidavit with the National Labor Relations Board.

8. Whether the trial judge gave an adequate cautionary instruction relative to the weight to be accorded the testimony of those government witnesses, former members of the Communist Party, who were receiving money from the Government while testifying.

9. Whether the instructions of the trial judge on the definition of the terms "membership" and "affiliation" were sufficient to guide the jury in determining whether appellant was a member and/or affiliated with the Communist Party on the dates on which he filed the affidavits.

10. Whether, in a prosecution for falsely denying (a) membership in the Communist Party and (b) affiliation with the Communist Party, the evidence is sufficient to sustain the verdict of guilty, where several witnesses testified to Communist activities of the appellant both before and after the dates of the signing of the affidavits.

COUNTERSTATEMENT OF THE CASE

The Government believes a counterstatement of the case is necessary since the appellant fails to state much of the evidence with which the Government proved its case. In addition, appellant urges the same interpretation of the evidence which he urged to the jury below, and which it rejected.

This appeal is from the conviction of appellant on four counts of a six count indictment (R. 69, 73, 879-880) (A. 69-73)¹ for the violation of 18 U.S.C. Section 1001, all counts charging that appellant made false statements to a Government agency, the National Labor Relations Board, in a matter within that Board's jurisdiction in three Affidavit[s] of non-Communist Union Officers (NLRB Form 1081)² which he filed with that agency on June 29, 1951, July 11,

¹ "A" will be used herein to refer to Appellant's Brief; "R" will refer to the Official Transcript of the Court Reporter; and "Ex." will refer to Government Exhibits.

² NLRB Form 1081 reads as follows:

The undersigned being duly sworn, deposes and says:

- (1) I am a responsible officer of union named below.
- (2) I am not a member of the Communist Party or affiliated with such Party.
- (3) I do not believe in, and I am not a member of nor do I support any organization that believes in or teaches the overthrow of the United States Government by force or by any illegal or unconstitutional methods.

1952, and June 3, 1953 pursuant to the provisions of Title 29 U.S.C. Section 159(h). Specifically, the indictment charged in Counts I, III, and V, that appellant falsely stated he was not then a member of the Communist Party, and in Counts II, IV, VI, that he was not then affiliated with the Communist Party.

The indictment under which the appellant was convicted was returned on June 22, 1954. The first prosecution witness was called on November 23, 1954, and the Government rested its case on November 30, 1954. Appellant's motion for a judgment of acquittal was denied on December 1, 1954 (R. 690-691). Appellant called his first witness on December 1, 1954 and rested his case on December 1, 1954. Appellant did not testify. The jury verdict of guilty on Counts I, II, III and IV and not guilty on Counts V and VI was returned on December 2, 1954 (R. 879-880). Counts V and VI were based on appellant's 1953 non-Communist affidavit. Defense motions in Arrest of Judgment and Motion for Judgment of Acquittal, or in the alternative for a New Trial were denied (A. 4) and sentence was imposed on January 10, 1955. The sentence was imprisonment for five years on each of the remaining four counts, the sentences to run concurrently (A. 3).

I. The Execution and Filing of the Non-Communist Affidavit by Appellant

That part of the Government's case which is concerned with the execution and filing of the non-Com-

munist affidavits by the appellant is not in issue. Appellant does not contend that the Government failed to properly prove the execution and filing of the non-Communist affidavits by him. Nor does he contend that the non-Communist affidavits were improperly admitted in evidence (R. 22-23).

II. Appellants Communist Party Activities:

Two Government witnesses, identified the appellant at a District Committee Meeting held for Communist Party Officers on January 1, 1949 (R. 107, 409-410, 439). Uncontested evidence shows that appellant paid Party dues in 1950 (R. 110) while he was obligated to execute an affidavit of a Non-Communist Union Officer (R. 111, 613, 614).³ There is no challenge to the testimony that appellant was designated in 1952 by a Party leader to administer organizational direction and to revive lagging Communist activity and dues collection in the Everett Section of the Communist Party (R. 121-122). In a meeting held in December 1952 appellant directed the distribution of Party literature, of unquestioned authenticity, that not only delineated a program for future Party meetings and a reading list of Communist Party classics and periodicals for the membership, but also challenged the "attacks" upon the Communist Party

³ Appellant was indicted on June 22, 1954, at which time the Statute of Limitations had expired, for the 1950 filing.

by "the monopolists [who] are attempting to destroy it" (R. 119, 122-123, 126-131, 136-137; Ex. Nos. 7 and 8). The record, as established by two witnesses, not only lists the meetings appellant attended in 1952 (R. 115, 131-133, 616) and shows that he had the power to designate the meeting time and place of a Communist Party meeting in 1953, (R. 137-139), but the evidence demonstrates appellant's continued allegiance to the Communist Party in May 1953 as expressed by his growing concern with those "stool pigeons" who were exposing its activities (R. 140-143, 616-618).

Government witness Clark M. Harper joined the Communist Party in Seattle in 1943 (R. 357). He became an active member in 1944, at the request of the Federal Bureau of Investigation (R. 359-360). Harper terminated his Party membership when he testified as a Government witness in a Smith Act trial on June 17, 1953, *United States v. Henry P. Huff, John Daschbach, et al* (R. 361). During the period of his activity he attended over 1000 Communist Party meetings (R. 361-362, 429). He rose in the Party hierarchy to hold positions as a member of the District Committee of the 12th District of the Communist Party in the State of Washington, from 1947 to December 1950 (R. 362, 376); and he was a Regional Party Organizer from 1950 to 1953 (R. 362, 376).

Harper described the District Committee as the body that transmitted the policies of the National Committee of the Communist Party to the lower eche-

lons in the Communist scale. He stated that Enlarged District Committee Meetings were concerned with topics of a political nature relating to Marxism and Leninism, the policies, strategies and tactics of the Communist Party, as well as a number of educational and political subjects dealing with current programs that the membership would implement (R. 375-376). To facilitate the dissemination of Party doctrine when a matter of special urgency arose, the Committee would invite the subordinate leadership functionaries, comprised of Club Chairmen and secretaries to what were termed, Enlarged District Committee Meetings (R. 377-378). Harper testified that a position as a Club functionary presupposed membership in the Communist Party, (R. 379) and two Government witnesses, Harper and Harley Mores, stated that only Communist Party members were admitted to Enlarged District Committee meetings (R. 108, 410).

The sanctity of Enlarged District Committee meetings was so carefully preserved that the conference rooms were checked for hidden microphones, the door guarded by Communist Party leaders (R. 109), and the chief of each delegation present was charged with making certain that none but Party members were in his group (R. 462). It was at such a meeting that witnesses Harper and Mores identified appellant at the Frye Hotel in Seattle on January 1, 1949 (R. 107, 409-410, 435).

Harper testified that the January 1st meeting

was held for special Communist Party Officers (R. 439) and that it was an important occasion (R. 441-442) heralding the return to the Seattle area of the District Committee Chairman, Mr. Huff (R. 373, 409). He recalled that it was held on an unprecedented date, the only such departure in all his experience in the Party (R. 451, 566). The meeting began at 9:00 or 9:30 and continued throughout the day (R. 437). Huff addressed the group (R. 409) and witness testified that the discussion of that meeting concerned a picket line that was to be strung about the County Court House and would be led by Mr. Daschbach (R. 409).

Harley Mores testified that he first joined the Communist Party in 1934 or 1935 (R. 92-93, 177) at Sultan, Washington (R. 178). Witness left the Party in 1936 or 1937 (R. 211) and rejoined again at the request of the Federal Bureau of Investigation (R. 95-96). He remained in the Party until May 17 or 19, 1953 when he testified for the Government at the Seattle Smith Act trial (R. 93). Mores has been a member of the Sultan Club and the Everett Club of the Communist Party (R. 106); he has been Chairman of the Gold Bar Club of the Communist Party (R. 97, 106); a Section organizer of the Communist Party in the Sultan, Washington area (R. 97); and was a member of the Regional Board of the Communist Party in Everett (R. 97). Mores stated that in these capacities he had attended conventions and Enlarged District Committee meetings of the Communist Party, in

Seattle, at which he identified appellant (R. 106).

Mores has known appellant since 1947 (R. 102) and was a member of Sultan Local 93 of the International Woodworkers of America (R. 92). Appellant served on the Executive Board of Local 93 in 1950 and continued in that capacity for three years (R. 17, 105). Mores first identified appellant as a member of the Communist Party in the Everett region (R. 102-103) on the basis of conversations he had held with appellant concerning Party policy and membership (R. 103). Mores had also collected Communist Party dues from the appellant (R. 103-110) and later in their relationship had deposited membership dues receipts with appellant (R. 103). Witness recounted that he had traveled in the company of appellant and other Party leaders when both were attending Party functions in Seattle (R. 109). The witness testified that he had accompanied appellant to Party meetings held in the area surrounding Gold Bar (R. 109) stating that “* * * there has been other leadership up there with him even before he became the leader there” (R. 109).

In September 1950 (R. 112) when appellant had visited Mores' home in Gold Bar, he paid \$12.00 as Party dues to Mores (R. 110). At the same time, appellant sought Mores' advice regarding the Party policy as it related to the signing of a non-Communist affidavit (R. 110). Both Mores and his wife, Mazie Mores, testified that appellant explained that he had

been elected to the Executive Board of the Skykomish sublocal of the Sultan Branch IWA, and would be required to file the affidavit (R. 104-105, 614). This information coincided with the testimony of Government witness Vern Castle, Secretary-Treasurer and Business Agent of IWA Local 93 (R. 15-17). Since Mores was reluctant to advise appellant in this matter, he suggested that appellant settle his dilemma by consulting with "the leadership in Everett" (R. 111, 614, 621).

At this point, Clark Harper from his experience as a member of the District Committee which transmitted and implemented Party policy, (R. 375-376) detailed the security measures adopted by the Communist Party (R. 568-571). Harper testified that the indictment of the top Party leaders in 1948 and the problem of the non-Communist affidavits (R. 568, 570) had marked the initiation of a new Party security program. Prior to that period the membership was held to strict compliance with the tenets of the Party constitution requiring the periodic payment of dues and regular attendance at meetings (R. 382, 387, 570). But this policy was changed when it became apparent that these requirements would conflict with the obligation of union leaders to execute the non-Communist affidavits (R. 570). Therefore, to implement the Party policy of retaining labor officers within the organization (R. 383, 569) without exposing them to prosecution (R. 382-383), members were told to sign the affidavits and to discontinue their

attendance at meetings (R. 383, 569-570). However to insure continued control of the membership, Party meetings were now confined to specific contact persons who met within small groups (R. 387, 455-456, 561-570). As added precaution the Clubs were ordered to destroy the membership cards (R. 133-134, 456, 568, 570), to desist from listing or naming their members (R. 570), and to curb formal Party meetings (R. 570).

Both Mores and Harper testified to the implementation of these measures. Mores related that the Sultan Club was split into sub groups because of the security edict (R. 105-106). He told of the discontinuance of records and bookkeeping practices and stated that these smaller units facilitated remembering the financial transactions that were formerly recorded (R. 133). Harper stated that he had not seen appellant at meetings between 1949 and 1954 because the Communist Party went underground (R. 456). He testified that where members were formerly allowed to meet in groups of five persons (R. 569) they were later restricted to groups of three (R. 456, 570). So stringent was this protective cover that it was difficult to meet with anyone unless you were appointed his Party contact (R. 456). Even the Clubs were forbidden to disclose the composition of their membership to each other (R. 569).

Appellant abided by these security precautions (R. 114, 273, 275, 621) and reappeared on the Com-

munist Party scene just prior to December 26, 1952 (R. 121). He was present at the home of the Communist Party leader in Everett when Mores was summoned to meet with his superior (R. 121). Until that date Mores had submitted his dues collections to the Everett Communist Party leader (R. 121). But at this conference Mores was told by this Party leader that “* * * he was turning that area over to Mr. Fisher up there, and Mr. Fisher would collect the dues and try to organize — help organize up there. Things wasn’t moving fast enough and he didn’t have time to do it, and he figured Fisher was the man to do it.” (R. 122). Then Mores testified, “I was to help Fisher, help collect, and turn dues over to him and receive my orders from him.” (R. 122).

The new role was exercised soon afterward. Both Harley and Mazie Mores testified that on December 26, 1952 appellant was present at a Communist Party meeting held in Mores’ home (R. 114-115, 616). The discussion at that meeting was confined to topics relating to the Communist Party (R. 115-116), and in this vein appellant stated that he had been delegated to assume further responsibility in that area and that he would initiate this assignment by organizing “* * * the woods, the Sultan Local” (R. 116).

At the December 26, 1952 meeting appellant’s renaissance in open Party activity was effected. On this occasion he supplied the witness, Mores, with Party literature that Mores was to distribute to the

membership (R. 117, 119, 120). While this marked the beginning of this phase of appellant's activity as it related to Mores (R. 118), it was a continuance of similar behavior begun on June 30, 1950. On that date, officers Charles James Odle and Thomas R. Durham of the Sumner Police Department had discovered appellant beside his car shortly before midnight (R. 77-78). The car and the ground around it was strewn with approximately 100 pamphlets, some bearing the title "Communism" and others relating to Marx (R. 75). This was just prior to the date that appellant was elected to the Executive Board of IWA Local 93 (R. 17) and before appellant sought advice from Mores regarding Party policy as it concerned the signing of the non-Communist affidavit (R. 110).

During December 1952 appellant delegated Mores to deliver the pamphlets to individuals in the Party (R. 122-123) who were to read them and pass them on to other members (R. 117-118, 136-137), and to take them to areas where they filled the gap left by the absence of a Club Chairman (R. 117). Mores stated, "I was instructed to give one more instruction on these papers, to just not lay them around where anyone could pick them up." (R. 138). The papers were also to be the basis for the discussion at a meeting that was to be held two weeks from the date of distribution (R. 137). Mores had no choice but to obey appellant's instructions or be expelled from the Party (R. 324), because, "That was the jobs of such guys as Fisher. You see, they had it, and I was

watched to see that I did it, and I did it." (R. 324).

The 1952 literature detailed a plea for Party registration and a reading list:

"A. On the Party.

1. Foster, HISTORY OF the C P U S A (last chapter).
2. Malenkov, October 1952 POLITICAL AFFAIRS (Report to 19th Congress, Section on The Party).
3. Foster, September, 1952, POLITICAL AFFAIRS (The Formation of the Communist Party 1919-1921).
4. Elmer Larson, October 1952, POLITICAL AFFAIRS (On Guard Against Enemy Infiltration).
5. Stalin, October, 1952, POLITICAL AFFAIRS (Speech at Nineteenth Congress).
6. Blake and Aptheker, September 1952, POLITICAL AFFAIRS (Flesh and Bone of the Working Class).

B. On Peace.

1. POLITICAL AFFAIRS, September, 1952, (Peace, Today's Critical Issue).
2. POLITICAL AFFAIRS, September, 1952 (On the Question of Sectarianism in Our Peace Activity).
3. Joseph Stalin's (ECONOMIC PROBLEMS OF SOCIALISM IN THE U.S.S.R.)." (Ex. 7, R. 126-127).

The pamphlet laid down proposals dictating the work to be accomplished by Party Chapters (Ex. 7,

R. 127-128). Another urged the membership to "rally to the defense of our Party and around our beloved leaders" (Ex. 8, R. 130) and expressed confidence in the growth of "our Party, its leaders and the working class" (Ex. 8; R. 130). On both of these exhibits received by Mores from the appellant in December 1952 (R. 119-120) he had made the notation, "Received from Al Fisher at Harley Mores, December 26, 1952" (R. 125-126, 128).

On January 17, 1953 (R. 139) appellant attended a Communist Party meeting to evaluate the fruits of the literature distributed by Mores (R. 134). Appellant went to urge the groups to more active Party work and to revitalize lagging membership and collection of dues (R. 137). At this meeting too, he gave Party literature to Mores (R. 138-139, Ex. 9).

A four hour Party meeting was held at Startup, Washington in May 1953, one week before Mores testified at the Seattle Smith Act trial (R. 140-142). The meeting was emblazoned in Mores' mind because he knew at that time that he would appear as a Government witness (R. 140-142). Mazie Mores also recalled this meeting (R. 616). She testified that appellant urged as many people as possible to attend the trial, and that he appealed for funds to support the defense (R. 617). Both Mazie and Harley Mores (R. 618, 142) recalled their apprehension when appellant related that one member, who had formerly collected dues for the Party, would no longer be given

that assignment for fear he would give the proceeds to the Government; and when appellant told of a former Regional Organizer whom he no longer trusted (R. 142). Appellant detailed his concern with the problem of stoolpigeons in this lengthy meeting (R. 142), reflecting a peculiar parallel to the literature he had himself disseminated:

There have been a few faint and weak-hearted who have dropped by the side of the road and even a few out and out renegades, but our Party is strengthened by the removal of this type of anti-working class element. We shall continue to guard our Party's purity and unity from the ideology of the class enemy. (Ex. 8; R. 129).

SUMMARY OF ARGUMENT

I

The Indictment Was Sufficient

A. The materiality of the false statements charged to have been made was adequately alleged, even though the word "material" was not used in the indictment. That the statements in question were material appears from the allegations made. This is all that was required. In any event, appellant does not even claim to have been prejudiced, and he clearly was not prejudiced.

B. The second and fourth counts of the indictment which allege affiliation adequately state offenses. The term "affiliation" as found in the statute has been upheld as against a challenge that it was unconstitu-

tionally vague. And an indictment containing a count based on affiliation was held to sufficiently advise the accused of the charge pending against him.

C. It was proper to charge two offenses arising out of the filing of each affidavit. It is well settled that one transaction may be the subject of several counts in an indictment. The test of sufficiency is whether each count requires the proof of additional facts. In this indictment different proof is required for each of the counts, and furthermore concurrent sentences were imposed on each count so that if the affiliation counts were found insufficient, the convictions on the membership counts would still be valid and not subject to reversal.

II

The Trial Court Did Not Err in Its Rulings on the Admission of Evidence

A. The testimony of the witness Harper regarding appellant's Communist Party activities before the dates of the affidavits in question was properly admitted. Evidence of appellant's Party activity before and after the dates in issue was properly admitted.

B. It was not error to permit the witness Harper to explain his negative answer to a question which required a categorical answer.

III

The Trial Court was Correct in Its Rulings on Excluding Evidence Which Appellant Attempted to Introduce

A. The Court properly ruled that the Government was not required to produce the receipts for compensation paid to the witness Mores by the Federal Bureau of Investigation. The only purpose for the admission of such evidence would have been to impeach the witness by showing interest or bias. Since the Government furnished a certification of the amounts paid, which was introduced in evidence, the receipts would have merely been cumulative, and would not have contained any additional ground for impeachment.

B. The contention of the appellant that the witness Harper had admitted to the prosecutor at his pre-trial interview that he had no knowledge of the Communist Party activities of the appellant is without merit. On cross-examination the witness testified that he had given the prosecutor all the information which he testified to at the trial and that he had even told him of additional Party activities of the appellant after the time he testified to, but that he was unwilling to testify to those later events because he could not be specific enough about them. Thus, there was no evidence of any prior inconsistent statement of the witness which would have justified calling the prosecutor as a witness.

C. The ruling, which excluded the testimony of Harper, before a Security Board, at which time it is

alleged he erroneously identified two persons, was proper. This was a collateral matter which had no bearing on any of the substantive issues of this case so that the ruling which excluded such evidence was proper.

IV

The Instructions to the Jury Were Correct

A. The judge properly refused to give the "two-witness" perjury instruction, since this was not a prosecution for perjury, but a prosecution under the "false statements" statute, which does not require that the false statement be under oath to be punishable. Congress' specific mandate that false non-Communist affidavits be prosecuted under the "false statements" statute is clear proof that the "two-witness" rule of perjury cases was not intended to apply in such prosecutions. Furthermore, the gist of the offense in such prosecutions is not the false swearing, but the filing of the false affidavit with the National Labor Relations Board.

B. It was not error for the trial judge to refuse to instruct the jury, in the exact language of the requested instruction, that testimony of witnesses who were in the employ of the Department of Justice or who were paid for their testimony must be examined with "greater scrutiny and care than the testimony of an ordinary witness." *Fletcher v. United States*, 158 F. 2d 321 (C.A.D.C.) does not require that any spe-

cific form of words be included in the instructions in "informer" cases, and, moreover, is clearly distinguishable from this case on its facts. An adequate cautionary instruction was given here. *Hupman v. United States*, 219 F. 2d 243 (C.A. 6), certiorari denied, 349 U.S. 953.

C. The instruction of the Court explaining the meanings of the words "membership" and affiliation" were sufficient. There was no danger that the jury could have been misled, by the cast of the language of the instructions, into thinking that they could convict merely upon a finding of past membership or affiliation as distinguished from membership and affiliation on the date of the affidavits of non-membership. These instructions furnished adequate guidance for the jury in their consideration of the acts and statements of the appellant which would constitute membership and affiliation on the dates in issue.

V

The Trial Court Properly Denied Appellant's Motion for a Judgment of Acquittal, or in the Alternative, for a New Trial

The evidence is sufficient to support the verdict both on the first and third counts, regarding membership in the Communist Party, and on the second and fourth counts, regarding affiliation with the Communist Party.

The issue under all counts was whether appellant falsely denied that he was a member of the Communist

Party and affiliated with the Communist Party when he executed his non-Communist affidavits on June 29, 1951, and July 11, 1952.

A. The Government substantiated the charges raised in the indictment by showing appellant's continued adherence to Communist Party tenets and continued activity with Communist Party programs, as demonstrated by two former members of the Party. Government witnesses Clark Harper and Harley Mores detailed appellant's initial activity in the Communist Party at a District Committee Meeting of the top Party leaders in January 1949. This District Committee Meeting was described as an important occasion commensurate with the Committee's function of interpreting the highest policies of the National Committee of the Communist Party for the membership in the regional organizations.

B. The evidence showed that in 1950 appellant paid membership dues to the Communist Party and was discovered by two Police Officers of the Sumner, Washington area, with approximately 100 pamphlets of Party literature. At the time of this activity, appellant was required to execute an affidavit of non-Communist Union Officer. To reconcile this requirement with his Party duties, appellant sought the advice of a Party functionary who referred him to the higher officers of the Party in Everett, Washington.

C. Government witness Harper described the Communist Party security program during the years

1948 to 1953. He stated that the security measures were designed to meet the problem facing the Communist Party membership in executing the affidavit of a non-Communist Union Officer. Harper's testimony demonstrated that the Party established exclusive "contact" groups, whose relations with other similar cells of the Party, were forbidden.

D. In 1952, appellant renewed his open activity, which had been curtailed by the security program of the Communist Party, when he was appointed to organize the Everett area for the Party and to revive flagging membership subscriptions and dues payments. Subsequent to his appointment, appellant was present at a Communist Party meeting on December 26, 1952, at which time he related his growing role in the Party hierarchy, and gave Party literature to a Communist functionary for distribution to the membership. The literature was used as the basis for future meeting agendas and prescribed a reading list of Communist Party material.

E. Appellant convened a meeting of the Communist Party on January 17, 1953, at which problems of dues and unsatisfactory membership activities were examined. At that time he exhorted the membership to more sustained effort in the Party's behalf and distributed Party literature.

At a meeting in May 1953, appellant urged Party members to active participation in fighting the Seattle Smith Act trial through attendance at the trial and

contribution of funds for the defense. At the same meeting, appellant expressed his growing concern with the problem of those "stoolpigeons" within the Party who were exposing its activities.

The Government submits that the uncontradicted evidence presented in the Court below details an irrefutable record of appellant's dedicated activity between January 1, 1949, and May 17, 1953. The open manifestations of such Party activities were diminished only when, pursuant to the edict of the Communist Party, the appellant went underground.

ARGUMENT

I

The Indictment Was Sufficient

Appellant contends that the indictment failed to set out the essentials of the offense charged and that it failed to set forth with sufficient precision and clarity the time, place and manner in which the offenses were committed and that it was so vague and indefinite that he was unable to prepare a proper defense.

An information or indictment is sufficient to meet modern requirements if it alleges basic facts covering the essential elements of a crime against the United States with enough particularity to apprise the defendant of the nature of the charge and to enable him to protect himself from a subsequent prosecution for the same offense. *Hagner v. United States*, 285 U.S. 427,

431; *Todorow v. United States*, 173 F. 2d 439, 447 (C.A. 9), certiorari denied 337 U.S. 925.

(a) Materiality Was Adequately Alleged

It is to be noted that appellant does not go so far as to question or deny the materiality of the false statements charged, since they were manifestly material. Nor does he claim to have been prejudiced in any way by the alleged failure of the indictment to cover materiality, and indeed it is plain that the alleged deficiency could not have prejudiced his defense in any manner. But in any event, the indictment was not even technically deficient in the respect claimed.

Assuming, *arguendo*, that appellant is correct in his contention that the statements must be material to the inquiry, this indictment sufficiently alleged materiality. The case of *Rolland v. United States*, 200 F. 2d 678 (C.A. 5), certiorari denied 345 U.S. 964, on which appellant relies, merely states that an indictment charging a violation of this section must allege that the false statements charged were material or allege facts from which their materiality may be shown. The indictment in this case clearly conformed to this rule. While the word "material" was not used in the indictment, it is not correct to say, as does appellant (A. 21), that it "does not allege that the statements were material. Nor does it state facts to show their materiality." The materiality of the false statements which appellant was accused of having made was charged in substance by virtue of the fol-

lowing allegations (A. 69-73): that appellant "in a matter within the jurisdiction of the National Labor Relations Board, did unlawfully, wilfully and knowingly use and file," two false writings and documents, namely 'affidavit of Non-Communist Union Officers' (Form NLRB-1080), knowing the same to contain false statements and representations, to-wit: that appellant was not then and there a member of the Communist Party" (Counts 1 and 3) and "that he was not then and there affiliated with the Communist Party" (Counts 2 and 4), and that appellant knew these statements to be false when he made them.

In the case of *Hupman v. United States*, 219 F. 2d 243, (C.A. 6), certiorari denied 349 U.S. 953, in which an indictment almost identical with the indictment⁴ in this case was filed, this same point was raised on appeal. The Court of Appeals said at page 248:

⁴ The indictment in the *Hupman* case was as follows:

"Count One

"That on or about December 15, 1949, in the Southern District of Ohio, Western Division, Everest Melvin Hupman aka Melvin E. Hupman, the defendant herein, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, did unlawfully, willfully, and knowingly in an 'Affidavit of Non-Communist Union Officer' (Form NLRB-1081) make a false, fictitious and fraudulent statement and representation, to-wit, that he was not a member of the Communist Party when in truth and fact the said Everest Melvin Hupman, aka Melvin E. Hupman, then and there well knew such statement to be false, fictitious and fraudulent as he

Equally lacking in persuasion is the complaint that the indictment was insufficient because of its failure to charge that the false statement was material or that the statement was made in a matter within the jurisdiction of the United States. Both affidavit and indictment, in effect proclaim materiality and jurisdiction. The appellant clearly was advised of the charge he had to meet and with specific identity to preclude the danger of double jeopardy.

The same point was again raised by the petitioner in the petition for certiorari.

It has been held, however, that an analysis of 18

then and there well knew he was a member of the Communist Party.

“Count Two

“That on or about December 15, 1949, in the Southern District of Ohio, Western Division, Everest Melvin Hupman, aka Melvin E. Hupman, the defendant herein, in a matter within the jurisdiction of the National Labor Relations Board, an agency of the United States, did unlawfully, willfully, and knowingly in an ‘Affidavit of Non-Communist Union Officer’ (Form NLRB-1081 make a false, fictitious and fraudulent statement and representation, to-wit, that he was not affiliated with the Communist Party when in truth and fact the said Everest Melvin Hupman, aka Melvin E. Hupman, then and there well knew such statement to be false, fictitious and fraudulent as he then and there well knew he was affiliated with the Communist Party.

“A True Bill.

“Ray J. O’Donnell

“United States Attorney

“Wm. R. Wilson, Foreman”

U.S.C. 1001 reveals that the false statements and documents clause, unlike the concealment clause, does not require that the misrepresented facts be material. *United States v. Lange*, 128 F. Supp. 797 (D.C. S.D. N.Y.); *United States v. Varano*, 113 F. Supp. 867 (D.C. M.D. Pa.). Thus, the indictment was in the language of the statute, and clearly apprised the defendant of the charges against him. *Potter v. United States*, 155 U.S. 438, 444; *Ledbetter v. United States*, 170 U.S. 606, 609-610.

In *Kay v. United States*, 303 U.S. 1, which involved a prosecution under a similar false statements statute, the Court said, at pages 5-6:

It does not lie with one knowingly making false statements with intent to mislead officials of the [Government] to say that the statments were not influential or the information not important.

For all these reasons, we submit the indictment made adequate allegations of materiality and there was no necessity to allege in *haec verba* that the statements were material.

(b) *Counts Two and Four Are Sufficient*

Appellant contends that the second and fourth counts of the indictment are defective in that the term "affiliation" is so vague, uncertain and indefinite that no intelligible standard of conduct is prescribed and no notice of the offense charged is given.

The affidavit provisions were considered in the case of *Inland Steel Company v. National Labor Re-*

lations Board, 170 F. 2d 247 (C.A. 7), affirmed 339 U.S. 382. In that case the Court said at pages 266-267:

The point is made that the section [159(h)] is invalid because the phrase 'any organization that believes in or teaches the overthrow of the United States Government by force or by any illegal or unconstitutional methods', 'affiliated with' and the word 'supports' are vague and indefinite and must fall before the First, Fourth and Fifth Amendments. For the reasons set forth in *National Maritime Union v. Herzog*, *supra*, I think the contention lacks merit * * * *Moreover, the language is not so vague that men of common intelligence would have to guess its meaning and differ as to its application.* It requires only that persons who knowingly engage in the activities set forth in § 9(h) or who knowingly believe in the enumerated doctrines, or who knowingly support organizations which disseminate such doctrines shall not obtain access to the machinery set up by Congress for the purpose of advancing a specific public policy; hence if an affiant honestly believes that he is not affiliated with the Communist Party, that he does not support any organization which to his knowledge teaches the overthrow of the United States Government * * * such an affiant would be in no danger of conviction under * * * 18 U.S.C.A. 1001. [Emphasis supplied]

In *American Communications Association v. Douds*, 339 U.S. 382, which affirmed the *Inland Steel Co. v. National Labor Relations Board* decision, *supra*, Chief Justice Vinson, speaking for the Court on the question of the constitutionality of the affidavit requirement, stated at pages 412-413:

The only criminal punishment specified [in Section 159(h)] is the application of § 35A of the

Criminal Code, 18 U.S.C., Section 1001, which covers only those false statements made 'knowingly and wilfully'. The question in any criminal prosecution involving a noncommunist affidavit must, therefore, be whether the affiant acted in good faith or knowingly lied concerning his affiliations, beliefs, support of organizations, etc, * * * And since the constitutional vice in a vague or indefinite statute is the injustice to the accused in placing him on trial for an offense, the nature of which he is given no fair warning, the fact that punishment is restricted to acts done with knowledge that they contravene the statute makes this objection untenable. As this court pointed out in *United States v. Ragen*, 314 U.S. 513: 'A mind intent upon wilful evasion is inconsistent with surprised innocence' * * * Without considering, therefore, whether in other circumstances, the words used in § 9(h) would render a statute unconstitutionally vague and indefinite, we think that the fact that under § 35A of the Criminal Code, no honest, untainted interpretation of those words is punishable removes the possibility of constitutional infirmity.

If the provisions of Section 159(h) are not unconstitutionally vague insofar as they call for the filing of an affidavit which employs the words membership, affiliation and support, as the cases above have held, neither then is an indictment alleging a false statement which employs the language of the statute.

In the *Hupman* case, *supra*, p. 26, the appellant raised the identical point, both in the Court of Appeals and in his petition for certiorari. The Court of Appeals for the Sixth Circuit said, at page 245:

In respect to the sufficiency of the indictment, it has been repeatedly held, as in the *Behrman* case, supra, 'It is enough to sustain an indictment that the offense be described with sufficient clearness to show a violation of law, and to enable the accused to know the nature and cause of the accusation and to plead the judgment, if one be rendered, in lieu of further prosecution for the same offense.' The indictment, in the present case, was thoroughly considered by Judge Martin of this court when sitting, by designation, in the District Court, he denied a motion to dismiss it for failure to state an offense. With his well considered review developed in his memorandum opinion of January 29, 1953, we are in full accord.

Thus, the contention of appellant that the term "affiliation" is vague and does not inform him sufficiently of the charge has been disposed of by the rulings of the courts, which have upheld the constitutionality of the statute and the validity of an indictment substantially similar to the subject indictment (see footnote 4, p. 26).

(c) *Membership and Affiliation Are Properly Charged In Separate Counts*

Appellant argues that since it is the filing of the affidavits containing the false statements which constitutes the offense, it was improper to charge each false statement in a separate count of the indictment.

It is well settled that one transaction may be the subject of more than one count in an indictment. *Fredrick v. United States*, 163 F. 2d 536, 546 (C.A. 9), certiorari denied 332 U.S. 775. As the Supreme Court

said in *Dealy v. United States*, 152 U.S. 539, 542:

It is familiar law that separate counts are united in one indictment, either because entirely separate and distinct offences are intended to be charged, or because the pleader, having in mind but a single offense, varies the statement in the several counts as to the manner or means of its commission in order to avoid at the trial an acquittal by reason of any unforeseen lack of harmony between the allegations and the proofs * * * Yet, whatever the purpose may be, each count is in form a distinct charge of a separate offence, and hence a verdict of guilty or not guilty as to it is not responsive to the charge in any other count.

In determining whether separate counts of an indictment constitute the same offense, the test to be applied is whether each count requires proof of additional facts or evidence. *Normandale v. United States*, 201 F. 2d 463, 464 (C.A. 5), certiorari denied 345 U.S. 999. According to that test there is no duplicity in this indictment, as proof of membership in an organization requires different evidence than proof of affiliation with that same organization would require.

This Court is the case of *Berg v. United States*, 176 F. 2d 122 (C.A. 9), certiorari denied 338 U.S. 876, when reviewing an indictment which contained several counts each of which charged the making of a false entry in a report filed with the Interstate Commerce Commission stated, at pages 125-126:

The falsification of the several entries was punishable in each instance as a separate crime. Each entry required proof of additional facts, in order

to establish the separate crime, whether made on the same report or different reports. * * *

In the case of *Seymour v. United States*, 77 F. 2d 577 (C.A. 8), there was an appeal from a conviction for perjury committed before a Senate Subcommittee. The multi-count indictment refers to individual matters of inquiry during the course of the defendant's interrogation. It was the contention of the defense that the indictment should have contained only one count and that such count should have embraced all of the questions and answers assigned. The Court of Appeals rejected the argument stating at page 581:

This contention is not well grounded. The matter covered by the indictment related to various alleged false statements in answer to questions concerning different matters * * *. Thus it appears that the statements covered by the several counts referred to different matters of inquiry. Neither the circumstances that all referred to the same general subject of inquiry or that all were made at the same hearing prevents each from being a separate and distinct crime punishable as such. The commission of perjury as to one matter does not absolve the witness or afford him immunity as to all other matters covered by his testimony at the same hearing.

The present indictment charges the defendant with making four distinct false statements. The fact that the false statements referred to in Counts I and II were contained in one affidavit and those in Counts III and IV were contained in another is not material

to a determination as to whether the four Counts of the indictment charge an identical offense in four different matters. The sole determining factor is that the statements dealing with membership and affiliation are different subject matters. Indeed, had the Government contracted each into a single count it could very properly be argued that such a count was duplications. An indictment drawn in that fashion would unquestionably be prejudicial and would lead only to confusion.

There is ample precedent for this treatment of plural counts. In criminal cases involving perjury and contempt of Congress, the courts have long recognized that several answers, or refusals to answer constitute separate and distinct offenses for the purpose of pleading and trial. However, as they were simultaneous and directed to one subject of inquiry they could give rise to only a single offense for the purpose of punishment. *United States v. Orman*, 207 F. 2d 148 (C.A. 3); *United States v. Yukio Abe*. 95 F. Supp. 991 (D.C. Hawaii).

As this court said in *Barnes v. United States*, 142 F. 2d 648, (C.A. 9), at page 650:

It is permissible to allege the commission of an offense in several separate counts, * * * but if proof of guilt under each count rests upon the same facts it is error to impose separate sentences or fines for each count.

It is submitted that in the instant case there was no departure from that rule as different facts were

necessary to prove each of the counts. However, if it were held that the same facts proved membership and affiliation it is submitted that there was no error, as the trial court imposed sentences on each count to run concurrently (A. 3). Consequently, even if it were found that it was erroneous to charge that each of the false statements constituted a separate offense, the appellant would not be entitled to prevail on this appeal as the membership counts and the convictions on those counts would still be valid, and error relating to only one of the counts would not warrant reversal. *Brooks v. United States*, 267 U.S. 432, 441; *Hirabayashi v. United States*, 320 U.S. 81, 85, 105; *Pinkerton v. United States*, 328 U.S. 640, 641-642 fn. 1. It is submitted that there was no error affecting either count.

II

The Trial Court Ruled Correctly on the Admission of Evidence

A. Appellant contends that the trial court erred in admitting the testimony of the Government witness Harper which it contends was irrelevant in that the direct testimony of Harper as to appellant's attendance at Communist Party meetings was limited to a period before the execution of the non-Communist affidavits; and the explanation which the court permitted Harper to give in answer to the question, whether or not he had seen the appellant at any Communist Party meetings after January 1, 1949. Appellant apparently

believes that since the fact in issue was his membership and affiliation on the dates on which the affidavits in question were signed, it was improper to admit evidence of his Communist Party activities before that date. This contention is without merit.

The statutory requirement (29 U.S.C. 159(h)) of an oath of non-membership in the Communist Party, which is a prerequisite to the utilization of the processes of the National Labor Relations Board, can be satisfied only by an affidavit drafted in the present tense:

* * * that he *is not* a member of the Communist Party * * *. [Emphasis supplied]

It was the Government's contention at the trial that appellant was a member of the Communist Party on July 29, 1951, and July 11, 1952, and that consequently his affidavits of those dates stating that he was not then a member were false. To convince the jury of this, the Government was required to adduce either direct evidence of appellant's membership on those specific dates or evidence of overt acts and facts occurring both before and after those dates which would warrant the jury in concluding beyond a doubt that he was a member of the Party on those dates. The Government presented a case of the latter sort. The evidence it adduced, if accepted by the jury as true, impelled the conclusion that appellant falsely stated that he was not a member of the Communist Party on the crucial dates.

The authorities cited by appellant (A 32) do not support his contention that the witness Harper's testimony of his membership before the dates in issue was erroneously received. In some of the cases cited (e.g., *Wolf v. United States*, 259 Fed. 388 (C.A. 8); *Kammann v. United States*, 259 Fed. 192 (C.A. 7); *Dalton v. United States*, 154 Fed. 461 (C.A. 7); *State v. Wenzel*, 72 N.H. 396, 56 A. 918; *Pooley v. Dutton*, 147 N.W. 154), the ruling of inadmissibility was based on the ground that the evidence in question did not have probative value on the issue with respect to which it was admitted.

In *Haupt v. United States*, 330 U.S. 631, 642, it was held that evidence of conversations and occurrences long before the indictment which consisted of statements indicating sympathy with Hitler and Nazi Germany and hostility to the United States, were properly admitted in a treason prosecution in order to show intent.

The Court of Appeals for the Second Circuit in *United States v. Dennis*, 183 F. 2d 201 (C.A. 2), affirmed, 341 U.S. 494, in holding that statements which defendants made before the acts charged became a crime and before the period of the alleged conspiracy were competent and relevant, said, at page 231:

* * * but it is nonsense to say that events occurring before a crime, can have no relevance to the conclusion that the crime was committed; and declarations are no different from any other evidence. How far back of the commission of the

crime one may go is a matter of degree, and within the general control of the judge over the relevancy of evidence. In the case at bar, there is not the least reason to hold that his discretion was abused. The same doctrine applies to evidence occurring before the acts charged had become a crime at all: e.g., in the case at bar the visits of some of the defendants to Moscow before 1940. Just as in the case of events occurring before the dates laid in the indictment, so events occurring before the conspiracy had become a crime, may have logical relevance to the conclusion that the conspiracy continued until after 1940. It is *toto coelo* a different question whether we are treating them as *media concludendi*, or as the *factum* itself. *Kammann v. United States*, 7 Cir., 259 F. 192, is not the contrary; the declarations of the accused before we were at war were extremely remote to prove his intent after we entered the war. There might indeed be a faint bias for supposing that one who sided with the Germans while we were neutral, would still side with them after we were enemies; but it was not surprising that the appellate court thought the inference too feeble to be within the trial court's discretion. However, in *Wolf v. United States*, 8 Cir., 259 F. 388, 393, although the report leaves it uncertain, apparently the declarations were made after we entered the war, and yet they were held to be improperly admitted; and in *Haywood v. United States*, 7 Cir., 268 F. 795, 806, there is a dictum to the same effect. We are not in accord with this reasoning; and it follows that we regard the admission of evidence of what any of the defendants did before the Smith Act was passed as competent and relevant. Indeed, it would have been equally so, had its use not been confined, as it was, to the individual defendants concerned: that is, it would have been had the judge concluded, as well as he might, that already all

the defendants were engaged in the same enterprise that was charged against them in the indictment. The only question that could arise was whether the interlude of the Communist Political Association between May, 1944 and July, 1945, made what was done earlier too remote rationally. Clearly the interlude did not do so. We hold that all the declarations were competent and relevant.

B. The appellant also contends that it was error for the trial court to permit the witness Harper to explain his answer to the following question (R. 412):

And had you seen him at Communist Party meetings after that date?

It has been held that the trial judge has discretion in ruling upon whether a witness may be permitted to explain an answer. *United States v. Stoehr*, 100 F. Supp. 143, 154 (D.C. M.D. Pa.), affirmed, 196 F. 2d 276, certiorari denied, 344 U.S. 826; *United States v. Graham*, 102 F. 2d 436, 441 (C.A. 2), certiorari denied, 307 U.S. 643. And a witness is ordinarily permitted to explain his answer where the question calls for a categorical answer. *Webber v. Auto Park Transportation Co.*, 138 Wash. 325, 244 P. 718, 719 (1926).

In this instance, since the question was one which called for a categorical answer, it was proper for the trial court to permit the witness to qualify his negative answer to the question. As it developed, the witness explained the Party security measures which were in effect at that time and also the possibility of his having

seen Mr. Fisher at a subsequent District Committee convention (R. 410-411). On cross-examination the witness Harper further explained this answer by testifying that at his pretrial interview he advised the prosecutor that while he had seen the appellant at other subsequent meetings, he was unwilling to testify regarding these occasions as he could not be specific enough about them (R. 566).

For these reasons, it is submitted that the trial court did not err when it permitted the witness Harper to testify as to appellant's Communist Party activities, and it properly allowed the witness to explain his answer to a question which required a yes or no answer.

III

The Trial Court's Rulings on the Exclusion of Evidence Were Correct

The appellant cites as error three rulings of the trial court which excluded evidence offered by him. The alleged erroneous rulings involved: the refusal of the trial court to compel the Government to produce the records of the Federal Bureau of Investigation dealing with the compensation of the witness Mores; the exclusion of the testimony of the Assistant United States Attorney, who presented the case, when appellant attempted to call him as a witness to show prior inconsistent statements by the witness Harper; the exclusion of testimony of the witness Harper in another proceeding having no connection with this case.

A. *The Receipts for Payments to the Witness Mores Were Properly Excluded*

Appellant contends (A. 36-40) that the trial court erred when it did not compel the Government to produce the receipts of payments made to the witness Harley Mores while he was posing as a Communist Party member from 1942 to 1953.

The witness Mores had on direct examination estimated the total amount he had been paid was about \$10,000. On cross-examination when the witness said that he had no way of checking the amount, appellant demanded that the receipts of the payments made to him by the Federal Bureau of Investigation be produced (R. 326). The Government then offered to stipulate that the amount was \$10,000 but this stipulation was rejected by appellant (R. 328). The Court ruled that there was not a sufficient showing for the production of the receipts, but that the total amount of compensation was material and should be furnished (R. 338). In response to this ruling the Government announced that the Federal Bureau of Investigation had reported the total amount paid to the witness was \$10,530 (R. 365). In the later stages of the trial a certification prepared by the Federal Bureau of Investigation, showing the sums received by the witness, was furnished the appellant, this was later admitted into evidence (R. 749; Ex. 10).

Facts tending to show interest or bias on the part of a witness may be elicited on cross-examination, *Ma-*

jestic v. Louisville & Nashville R. R. Co., 147 F. 2d 621, 627 (C.A. 6); and ordinarily, evidence that a witness is employed by a party to the action is admissible to show bias or interest, *Sprinkle v. Davis*, 11 F. 2d 925, 931 (C.A. 4), certiorari denied, 314 U.S. 647. While employment of a witness may be considered on the point of his credibility, it is not of itself a sufficient reason for disregarding his testimony. *Arnall Mills v. Smallwood*, 68 F. 2d 57, 59 (C.A. 5); *Wabash Screen Door Co. v. Black*, 126 Fed. 721, 726 (C.A. 6).

The appellant on this basis then was entitled to elicit from the witness Mores the information of his employment by the Government and the amount of his compensation. In this attempt he received the estimate of the witness as to the amount and a certification of the amount by the Government. It is to be noted that the witness' estimate was within \$500 of the actual amount paid, not a sufficient difference to constitute contradictory testimony.

Since the appellant was afforded an unrestricted opportunity to bring the fact of the witness' employment and the amount of his compensation, certified to the penny, before the jury, it is submitted that his right to show bias or interest on the part of the witness was in no way curtailed. The payment records of the Bureau could not have thrown any further light on the subject of the bias or interest of the witness, therefore, the refusal of the court to order their pro-

duction was not prejudicial to the rights of the appellant.

B. *The Trial Court Properly Refused to Allow Appellant to Call the Prosecutor as a Witness*

Another contention of the appellant is that the trial court erred when it did not permit him to call the prosecutor as a witness. There is no merit to this contention.

After the Government had rested and appellant's motion for a judgment of acquittal had been denied, appellant advised the court of his intention to call the prosecutor as a witness (R. 691). It was contended that his testimony would bear upon the credibility of the witness Harper by showing a statement to the prosecutor at the time of the pre-trial interview that he had no knowledge of appellant's Communist Party activities.

The prosecutor, during the direct examination of the witness Harper, at a bench conference in which he was advancing his reasons for permitting the witness to testify regarding Communist Party security policy, stated (R. 385):

I think it is important for this reason: that during this period — to show that one Communist Party member did not meet with too many others as previously for the reason — *showing that possibly it might be adduced here that the only witness showing Mr. Fisher's implication in the case is Harley Mores.* I direct these and wish to establish that the security measures were taken

where there was only, maybe, two or three persons that knew or met together during this time who were in the Party so that if you were left with a situation, like maybe here, where you would have the Defendant, Harley Mores, and maybe only one or two others, that they would know that the Defendant was in the Party at the time. [Emphasis supplied.]

Appellant wrenched the italicized words from their context and has attempted to construe them as an admission by the prosecutor that the witness Harper had no knowledge of the Communist Party activities of the appellant. While relying on his interpretation of this particle of the prosecutor's statement as an admission that Mores was the only witness who could implicate appellant as a Communist Party member, appellant conveniently ignores the testimony of the witness Harper on cross-examination (R. 564-567). There the witness testified that he had been interviewed by the prosecutor one week before the trial (R. 564); that at this interview he had been asked the same question as at the trial and had given the same answers (R. 565); that he told the prosecutor of having seen appellant at the January 1, 1949 meeting and that he told of having seen him at other subsequent meetings, but that he would only testify to the January 1, 1949 meeting as that was the only one he absolutely remembered (R. 565-566).

Thus the contention of appellant that Mores was the only witness who could implicate him with the

Party was demolished by the testimony of Harper on cross-examination.

If the trial court had acceded to the demands of appellant and permitted him to call the prosecutor as a witness and interrogate him with regard to the testimony of Harper, the only evidence which could have been adduced would have corroborated the cross-examination testimony of Harper, as there was no evidence of any prior inconsistent statement by the witness Harper.

C. The Limitation on the Cross-examination of the Witness Harper Was Not an Abuse of Discretion by the Trial Court

Appellant also cites as error the ruling of the trial court which refused to permit appellant to cross-examine the witness Harper with respect to an alleged mistaken identification at another proceeding.

During the cross-examination of Harper appellant questioned him with respect to a prior Security Board hearing and then asked about his alleged mistaken identification. The prosecutor objected to this question (R. 514). This objection was sustained by the court (R. 515). After the jury had been dismissed appellant made an offer of proof that the questions would show that the witness had made a false identification at a Security Board hearing when he was attempting to identify a person as having attended Communist Party meetings (R. 518-522). Appellant stated that this subject was a proper one since it had a bear-

ing upon the witness' ability to identify the appellant and would also tend to impeach him (R. 478). The Court stated that to permit cross-examination on this subject would bring in a collateral issue which would tend to confuse the main issues of the case (R. 487).

While it is difficult to ascertain the basic theory on which appellant was proceeding in his attempt to impeach Harper the closest of the recognized grounds of impeachment appears to be prior inconsistent statements. But as this Court held in *Shanahan v. Southern Pacific Co.*, 188 F. 2d 564 (C.A. 9), a witness may not be impeached by contradiction on a collateral matter. It has long been established that the self-contradiction of a witness by prior inconsistent statements may be shown only on a matter material to the substantive issues of the case. *Cwach v. United States*, 212 F. 2d 520, 530 (C.A. 8).

It is evident that in this instance the proffered evidence was not logically relevant to establish any material fact in this case. Even if the witness had been mistaken in identifying another person it had no bearing upon his testimony regarding appellant's Communist Party activities.

While collateral matters may be gone into on cross-examination to a limited extent for the purpose of testing the credibility of a witness, *United States v. Lawinski*, 195 F. 2d 1, 7 (C.A. 7), the scope of such examination is within the discretion of the trial court. *United States v. Augustine*, 189 F. 2d 587, 590 (C.A.

3). Unless such discretion is abused there can be no reversal. *Wright v. United States*, 183 F. 2d 821, 822 (C.A. D.C.).

It is submitted that there was no abuse of discretion in the ruling of the trial court in this instance.

IV

THE INSTRUCTIONS TO THE JURY WERE CORRECT

It is contend by the appellant that the trial judge erred in his instructions to the jury with respect to three matters, which he has listed under headings, A through C (A. 44-59). The alleged error referred to under heading A was the refusal of the Court to instruct the jury that the proof required for a perjury conviction was required in order to convict appellant in this case, and also that the Court's instruction that appellant could be convicted on circumstantial evidence was erroneous. Under heading B appellant argues that the Court did not properly instruct the jury on the weight to be accorded the testimony of Government witnesses who were former members of the Communist Party, and who were being paid by the Government while testifying. Under heading C he contends that the Court erred in its instructions on the definitions of "membership" and "affiliation" and in refusing to give the instructions proposed by appellant on these points.

A. *The Refusal to Give the "Two Witness" Perjury Instruction—*

Appellant contends (A. 44-50) that it was error for the trial judge to refuse to instruct the jury that you cannot find the defendant guilty if the proof of falsity of the affidavit is merely circumstantial.

* * *

As I have instructed you the plaintiff, government, must establish the falsity of the statements alleged to have been made by the defendant under oath by the testimony of two independent witnesses or by the testimony of one witness and corroborating circumstances * * *. (A. 45).

This contention is without merit, as the requested instruction had no applicability to this case.

It is to be noted that 29 U.S.C. 159(h), in accordance with which the affidavit in this case was filed, specifically provides that "The provisions of section 35A of the Criminal Code [now broken up into a number of sections, of which 18 U.S.C. 1001 is one] shall be applicable in respect to such affidavits." Since 18 U.S.C. 1001 is not a perjury statute, the fact that Congress declared that the filing of false affidavits should be punished as provided in 18 U.S.C. 1001 is clear proof that the "two witness" rule of perjury cases was not intended to apply to prosecutions brought thereunder.

Furthermore, it is not the false *swearing* but the *filing* with the National Labor Relations Board of a false affidavit which constitutes the offense defined

by 18 U.S.C. 1001 read in the light of 29 U.S.C. 159(h) ; *United States v. Valenti*, 207 F. 2d 242 (C.A. 3). Hence, even where a false non-Communist affidavit is executed, no offense under those sections is committed unless and until the affidavit is filed with the Board. (Id. at 244). For this reason the indictment in this case was careful to charge that appellant "did * * *, use and file * * * with said Board a false writing and document, namely," etc.

It is submitted that the Trial Court properly instructed the jury that a conviction could be based on circumstantial evidence alone. In the *Hupman* case, *supra*, a case in which the defendant was indicted for false statements on a Taft-Hartley affidavit, the Court of Appeals for the Fifth Circuit said, at pages 247:

Circumstantial evidence from which reasonable inferences may be drawn will sustain a verdict [citing cases]. We think the record presents circumstances which warrant a reasonable inference that the appellant signed and either filed, or caused to be filed, the affidavit here involved.

B. *The Instruction on "Informers"*

It is contended by appellant (A. 50-53) that the Trial Court erred in refusing to give his Requested Instruction No. 5.

The requested instruction was based on the so-called " 'two-witness rule' in perjury cases," that is the "special rule which bars conviction for perjury solely upon the evidence of a single witness." *Weiler v.*

United States, 323 U.S. 606, 608. According to that rule, the Government, in a prosecution for perjury, "must establish the falsity of the statement alleged to have been made under oath, by the testimony of two independent witnesses or one witness and corroborating circumstances" (Id. at 607), and the jury must be so instructed (Id. at 610-611). That the rule is limited to prosecutions for perjury is clear from the Supreme Court's explanation of the rationale behind the rule (Id. at 609):

Lawsuits frequently engender in defeated litigants sharp resentments and hostilities against adverse witnesses, and it is argued, not without persuasiveness, that rules of law must be so fashioned as to protect honest witnesses from hasty and spiteful retaliation in the form of unfounded perjury prosecutions.

* * * Since equally honest witnesses may well have differing recollections of the same event, we cannot reject as wholly unreasonable the notion that a conviction for perjury ought not to rest entirely upon "an oath against an oath." The rule may originally have stemmed from quite different reasoning, but implicit in its evolution and continued vitality has been the fear that innocent witnesses might be unduly harassed or convicted in perjury prosecutions if a less stringent rule were adopted.

The instant case was not a prosecution for perjury, which offense is defined and punished by 18 U.S.C. 1621, but a prosecution under the "false statements" statute, 18 U.S.C. 1001. That statute provides for the punishment of—

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully * * * makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry * * *.

The statement need not be under oath to come within the proscription of this statute, though of course, as in this case, it may be one made under oath. Consequently, the "two-witness" rule has no application to prosecutions brought under it. *Todorow v. United States, supra*, p. 25.

The testimony of the witnesses who were at the time of their testimony in the employ of the Department of Justice or who were paid directly for their testimony in this case must be examined with greater scrutiny and care than the testimony of an ordinary witness for the purpose of determining whether such testimony is colored in such a way as to place guilt upon a defendant in furtherance of the witnesses' own interest.

The contention is without merit.

The phraseology of appellant's requested instruction was evidently constructed by combining verbatim two passages from the opinion in *Fletcher v. United States*, 158 F. 2d 321 (C.A.D.C.). That case involved a narcotics conviction in which the sole evidence against the defendant was the testimony of a paid informer-addict. The Court reversed the conviction because, as it held, at page 321:

* * * the trial court erred in refusing a requested instruction to the effect that the informer's testimony *should be examined by the jury with greater*

scrutiny and care than the testimony of an ordinary witness. (Italics supplied)

Later in the opinion occurs the following language; (as will be seen, the italicized portion forms the basis of the latter part of the appellant's requested instruction (Id. at 322)):

Granting that the credibility of the testimony of a paid informer is for the jury to decide, it nevertheless follows that where the entire case depends upon his testimony, the jury should be instructed to scrutinize it closely *for the purpose of determining whether it is colored in such a way as to place guilt upon a defendant in furtherance of the witnesses' own interest.* (Emphasis supplied).

The Fletcher case thus is authority for the proposition that, where the sole evidence against a defendant is the uncorroborated testimony of a paid informer, the jury should be instructed to scrutinize it with care in the light of the possible interest of the informer in aiding the procuring of a conviction. But it is plain from the Fletcher opinion that the Court was not, as appellant seems to believe, laying down any verbal formula for inclusion in the instructions in prosecutions involving the use of informer testimony. That such was not the intent of the Court may be seen also from its subsequent opinion in *Cratty v. United States*, 163 F. 2d 844, 850 (C.A.D.C.). In the instant case, as we shall point out in a moment, a suitable cautionary instruction was given.

Furthermore, the instant case is clearly distinguishable from the *Fletcher* case on its facts. In *Fletcher*, as we have noted, the sole evidence against the defendant was the uncorroborated testimony of a single paid informer. In the case at bar, on the other hand, the Government's evidence included the testimony of three former members of the Communist Party as well as numerous documentary exhibits.

The trial judge, while refusing to give the requested instruction, did give a cautionary instruction. It was as follows (R. 845-846):

The evidence shows that certain of plaintiff's witnesses were in times past engaged by the government to join the Communist Party and make reports to the Federal Bureau of Investigation of such facts as they learned during such association; and also that they were paid considerable sums of money while so engaged. In weighing the testimony of such witnesses in this case you should scrutinize their testimony with care and caution and after so considering their testimony give it just such weight as you believe it to be entitled to in view of all the circumstances of the case as disclosed by the evidence. If you find they have testified truthfully such testimony is as good as the truth testified to from any other source.

An identical instruction on informers was refused in the *Hupman* case, *supra*, the point was raised in the brief on appeal and the petition for certiorari but was not deemed worthy of consideration by either Court. It is submitted that the foregoing cautionary instruction was clearly adequate and appropriate to the cir-

cumstances of this case. Cf. *Communist Party v. Subversive Activities Control Board*, (decided December 23, 1954; slip opinion pp. 54-55), certiorari granted 349 U.S. 943.

C. *The Instructions of the Court on "Membership" and "Affiliation" Were Correct*

The contention of the appellant that the membership instruction of the Trial Court was so "vague and indefinite as to furnish the jury with no ascertainable standards of guilt" and that the Trial Court failed to give a "comprehensible definition of membership" are without merit. (A. 53-59). The trial judge explained the meaning of membership as follows (R. 853-854):

As used in the indictment and statute the words "member" and "affiliated" when applied to the Communist Party, have no unusual or different meaning apart from their normal or common usage. Webster's New International Dictionary defines "member" as follows:

One of the persons composing a society, community, or party; an individual who belongs to an association.

"Affiliate" is defined as follows:

To connect or associate one's self with; to adopt, hence to bring or receive into close connection; to ally.

The word "member" is a word of common knowledge and when related to an organization has a definite meaning. Membership in an organization is one

of the most common and frequently exercised privileges of an American citizen, and it is doubtful if there is any juror who does not understand the acts which constitute membership in an organization, Communist Party or otherwise. It is unreasonable to argue then, as does appellant, that the individual jurors could not have understood the meaning of the term. The fact that Congress when it enacted the Labor Management Relations Act of 1947 (29 U.S.C. 151 et seq.) did not undertake a definition of the term membership is an indication that the legislators intended to use the word in its ordinary sense. Thus, the recourse by the trial court to a dictionary definition of the word was by no means improper.

If the argument of appellant were carried to its logical conclusion, there would be a duty placed upon the trial court to define with particularity every word used in the statute and indictment, regardless of whether the word was used in its ordinary sense or the clarity of the thought it conveyed. Appellant has cited no authority for so grossly underestimating the intelligence of the ordinary juror.

In the case of *American Communications Association v. Douds*, 339 U.S. 382, the Supreme Court held that Section 9(h) and (Title 29 U.S.C. 159(h)) was not unconstitutionally vague in that the terms, including membership in the Communist Party, were not defined in the statute and therefore did not afford a reasonable standard for determining guilt. In uphold-

ing the constitutionality of this section the Supreme Court stated that "no honest untainted interpretation is punishable" and pointed out that:

The state of a man's mind must be inferred from the things he says or does * * * false swearing and signing the affidavit must, as in other cases where mental state is in issue; be proved by the outward manifestations of state of mind.

It is precisely the outward manifestations of appellant's state of mind, the relevant acts and statements of appellant as reflected in the trial record, that the court instructed the jury to consider in determining whether appellant was a member of the Communist Party when he signed his 1951 and 1952 affidavits.

V

The Evidence Is Sufficient to Support the Verdict

The Government submits that there is no merit to appellant's contention that judgments of acquittal should have been entered because there is insufficient evidence to support the verdicts of conviction on Counts One, Two, Three and Four (A. 59-68).

Moreover, since concurrent sentences were imposed (A. 3) the judgment of conviction must be affirmed if the evidence establishes a sufficient basis upon which the verdict on any count can be justified. *Brooks v. United States*, 267 U.S. 432, 441; *Hirabayashi v. United States*, 320 U.S. 81, 85, 105; *Pinkerton v. United States*, 328 U.S. 640, 641, 642 fn. 1. The

Government contends that the evidence suffices to support the verdict on each of the four counts.

“We may say that the evidence is insufficient to sustain the verdict only if we can conclude as a matter of law that reasonable minds, as triers of the fact, must be in agreement that reasonable hypotheses other than guilt could be drawn from the evidence.” *Stoppelli v. United States*, 183 F. 2d 391, 393 (C.A. 9), certiorari denied 340 U.S. 864; *Curley v. United States*, 160 F. 2d 229, 232, (C.A.D.C.), certiorari denied 331 U.S. 837.

As the Supreme Court said in *Glasser v. United States*, 315 U.S. 60, 80: “The verdict of a jury must be sustained if there is substantial evidence, taking the view most favorable to the Government, to support it.” The Government’s evidence in this case we submit has fulfilled the required standards of proof on each of the four counts.

The issues at trial, so far as they are now pertinent, are whether appellant falsely denied that he was a member of the Communist Party on the dates of his affidavits of June 29, 1951 and July 11, 1952 (A. 69-71; Counts One and Three), and whether on the same dates he falsely denied that he was affiliated with the Communist Party (A. 69-71; Counts Two and Four). Although the evidence adduced in the lower court is detailed in the Counterstatement of the case, the Government will restate some of the highlights at this point.

The evidence first established that the appellant had attended an Enlarged District Committee Meeting

of Communist Party functionaries on January 1, 1949 (R. 107, 409-410, 435, 439). Two witnesses, Clark Harper and Harley Mores, testified that an Enlarged District Committee Meeting was one of the most closely guarded of organizational sessions, confined exclusively to members of the Communist Party (R. 109, 462), and concerned with topics of top Party policy (R. 375-378, 380). Specifically, the witnesses related that the composition of the meeting, aside from the District Committee members present, was confined to the leadership group in the Communist Party composed of Club Chairmen and Secretaries (R. 377-378). The importance of this particular session on January 1, 1949, was emphasized by the witness Harper, who stated that in his nine years in the Party, as a veteran of over 1000 meetings (R. 359-362, 429), he was unable to recall a single instance when a District Committee meeting had been held on New Year's Day (R. 451, 566). Harper testified that the meeting was held on the occasion of the return of Henry Huff to the Seattle area (R. 375, 409, 439); Harper related that the discussion at the meeting detailed the Party role in forming a picket line that was to be strung about the County Court House in Seattle, to be headed by John Daschbach (R. 409).

Harley Mores testified that in September, 1950, appellant had visited his home in Gold Bar, Washington (R. 110, 112). On that occasion, Mores related, appellant had paid him \$12.00 in Party dues and had sought Mores' advice regarding Party policy as it re-

lated to the signing of the Non-Communist affidavit by Party members (R. 111). This inquiry was occasioned by the fact that appellant had recently been elected a member of the Executive Board of IWA Local No. 93 (R. 15, 17, 104-105, 614), and as a member of this Board would now be compelled to execute an affidavit of a Non-Communist Union Officer (R. 22, 28, 50, 51, 57, 70). Mores, reluctant to advise the appellant in this matter, had referred him to the "leadership in Everett" (R. 111, 614, 621). Further justification for appellant's concern with the execution of this affidavit in the face of his Party activities is indicated by his earlier actions on June 30, 1950 (R. 74, 78). In the midnight hours of that date he was found by two officers of the Sumner Police Department (R. 74, 78) beside his car, which at that time was strewn with approximately 100 pamphlets, some bearing the title "Communism", and others covering topics relating to Marx (R. 77-78). When questioned by the officers about his allegiance to the Party at that time, appellant had replied, "Oh no; I just read the stuff." (R. 76). This, in regard to 100 pamphlets of similar content.

That appellant had received the advice from the "leadership in Everett" (R. 111) that he sought, can be fairly inferred from the testimony of Harley Mores and his wife Mazie, that soon after the 1950 meeting appellant absented himself from open Party business and was only seen occasionally in the period 1950 to 1952 (R. 114, 273, 275, 621). That this advice was in

line with the established Party policy at that time was disclosed by the witness Harper from his experience as a member of the policy making District Committee of the Communist Party (R. 373, 375). Harper related that in November, 1948, a new security program had been initiated by the Communist Party (R. 378). This was to meet the new problem posed to its members by the Non-Communist Affidavit of Union Officer required by the recently enacted Labor Management Relations Act of 1947 (R. 569-570). To protect the Party in its gains in labor unions through the recruitment of those in the top labor leader positions, the Communist Party devised a program allowing its membership to be excused from the rigid requirements imposed by the Communist Party Constitution and permitting them to sign the Non-Communist affidavit and to discontinue their attendance at Party meetings (R. 569-570). To implement the new measures the whole fabric of the Communist organization went underground (R. 456). Clubs were instructed to destroy membership cards (R. 133, 387-388, 456, 569-570), to desist from calling Party members by name (R. 462, 569-570), to discontinue the practice of keeping records and books with relation to the collection of dues (R. 133), and to terminate formal Party meetings (R. 569-570). To fill the gap thus opened by the new security procedures, and to keep the membership constant, selected contact persons were appointed to meet in groups of three, while they severed relations with the other groups in the Party and with persons outside

the formal contact unit (R. 456). Even the Party Clubs were cautioned against detailing a list of their membership to other Clubs in the Communist organization (R. 569).

Appellant's compliance with these security measures lasted until a period just prior to December 26, 1952, when the witness Mores testified that he had met appellant at the home of a Party leader in Everett (R. 121). This meeting related to appellant's selection as the new functionary in the Communist hierarchy, designated to organize the area near Everett and charged with the receipt of dues from such couriers as Mores (R. 122).

The new role was exercised a short time later, at a meeting on December 26, 1952, wherein witness Mores testified, nothing but Communist Party matter was discussed (R. 115). At this meeting, appellant told Mores that in line with appellant's greater responsibilities in the area he had decided to organize "the woods, the Sultan local" 93 of the International Woodworkers of America (R. 116). This was a signal event for still another action by the appellant, for it was on this occasion that he supplied the witness Mores with Party literature for distribution to members in the outlying areas for their perusal with regard to future Party agendas (R. 117-118; Ex. 7). The literature detailed not only the specific points of order that were to be accomplished by each Party cell, but listed prescribed Party literature, ranging from Elmer Lar-

sen's article in the Political Affairs issue of October, 1952, entitled "On Guard Against Enemy Infiltration" to Malenkov's "Report to the 19th Congress, Section on the Party" and Foster's "History of the Communist Party, USA" (R. 126-127; Ex. 7). That appellant realized that this distribution of literature was more than a normal invocation of the privileges of freedom of speech and dissemination of printed matter, is intimated by his instruction to Mores that he was "just not [to] lay them around where anyone could pick them up" (R. 138; Ex. 7, 8). On that occasion, Mores stated, he had no alternative but to obey appellant's instructions because, "That was the jobs of such guys as Fisher" and he had to do as he was told or be expelled from the Party (R. 324).

Two weeks later, on January 17, 1953, appellant attended a Communist Party meeting in order to evaluate the work that had been accomplished in line with the suggestions detailed in the literature he had given to Mores for distribution (R. 134, 137). At the January 17 meeting appellant urged the group to more active work for the Party in his effort to revitalize their flagging membership program and the collection of dues (R. 137-140). At this meeting too, he gave Party literature to Mores (R. 138; Ex. 9).

The evidence also disclosed that one week before Mores testified in the Seattle Smith Act trial in 1953, appellant was present at a four-hour Party meeting held near Startup, Washington (R. 140-141). At this

meeting appellant urged the membership to attend the trial "and make a showing", and to contribute funds for the support of the defense (R. 617). But the meeting remained emblazoned in Mores' mind because on this eve of Mores' testimony for the Government, appellant detailed to the group his growing concern with the problem of "stool pigeons" in the organization. He intimated in his new role of importance that one member who had formerly collected dues for the Party would no longer be given that assignment for fear he would turn the proceeds over to the Government; and that a former Regional Organizer was no longer to be trusted (R. 142, 617-618).

The evidence in this case is overwhelming that appellant was continuously a member of the Communist Party and affiliated with the Party in the years ranging from January, 1949 to May of 1953. There is substantial evidence to warrant a jury's finding he continued as a member of the Party and was affiliated with the Party on June 29, 1951 and July 11, 1952, the periods covered in the indictment. We submit that the evidence is sufficient to support the verdict of guilty on Counts One, Two, Three and Four.

Appellant disparages the testimony of the witness Harley Mores as completely vague and indefinite on the material points at issue. He states that Mores was completely unable to relate the dates which were relevant to the indictment (A. 63); and he tortures the record in citing the isolated instance where Mores

offers his conclusion that appellant was a member of the Communist Party (A. 63). But appellant ignores Mores' uncontroverted testimony detailing times, places and events in the face of concerted cross-examination lasting almost four hours. He ignores the meeting with a Party leader in 1952 at which appellant was present and appellant was given the reins of the Party organization in the Everett area. He ignores the December 26 meeting of 1952, and the content of the literature and instructions that appellant had given to Mores on that occasion for distribution to the membership. He omits the conversations relating to dues and collection of monies for the Party in the two 1952 instances where he met with members of the Communist Party.

Appellant disparages Mores' reply to a question that he had ever received literature from the defendant (A. 64), but never meets the fact of Government exhibits 7 and 8 and their notation, "Received from Al Fisher at Harley Mores, December 26, 1952" (R. 125-126, 128), nor Mores' statement, "* * * from that time on I received my literature directly from Al Fisher" (R. 118).

Appellant distorts the importance of the meeting appellant attended in May, 1953, as only relevant on the issue of whether appellant signed a false affidavit on June 5, 1953 (A. 67). He neglects to estimate the bearing this has on highlighting the line of appellant's Party activity running from Janury, 1949

through to 1953, covering the full period of the indictment at issue in the present instance, and providing the reasonable inference that appellant's activity at this time was both continuous and important. Appellant further criticized the characterization of meetings appellant attended (A. 63-67) as opinions of the witness Mores, but never meets the issue posed by the testimony relating to the topics covered at such meetings, their purposes, or the loyalties of the individuals who participated.

Appellant refers to the record of the argument of counsel on motion for a directed verdict of not guilty (A. 62) and his dissertation quotes at great length from Congressional hearings wherein the point was made that Section 9(h) calls only for denial of present membership in the Communist Party. While there is no dispute as to this proposition, even a cursory perusal of this argument reveals a studied effort to confuse the question of substantive law with the requirements of the rules of evidence.

Appellant's reliance on the *Douds* case (A. 60) (*American Communications Assn. v. Douds*, 339 U.S. 382) is also an attempt to confuse a question of substantive law with the evidentiary problems involved in proving a criminal offense. The *Douds* case held that Section 9(h) is constitutional because it is limited to a denial of present membership and, hence, is not objectionable as a Bill of Attainder. The question of whether membership as of a given date may be determined

on the basis of membership prior and subsequent to the date presents an entirely different issue and is simply the question whether the evidence presented rises to that quantum necessary, as a matter of law, to permit the case to go to a jury. The Government is not relying upon evidence of prior membership alone but is relying on the total of the evidence as to appellant's Communist Party membership, both prior and subsequent to the execution of the affidavits. Appellant's position that such constant and consistent behavior is not probative of appellant's status and intent when he filed the affidavit is exposed by its statement alone.

Appellant's contentions with regard to "memberships" and the questions of the crime of perjury as they relate to this case are discussed in Point IV of the Government's brief.

Appellant's argument as to the sufficiency of the evidence is an elaborate and specious intellectual exercise which concerns itself largely with factual issues already resolved by the verdict of the jury.

Bearing in mind that the Government is relying not only upon the evidence of pre-affidavit membership and affiliation, but upon the basis of post-affidavit membership and affiliation as well, the question is one as to the weight of the evidence, a matter normally within the province of the jury. *Hupman v. United States*, 219 F. 2d 243 (C.A. 6), certiorari denied, 349 U.S. 953.

Unless it can be said that the facts presented were too remote and inconsequential to constitute a prima facie case, the fact issues in this proceeding were properly submitted to the jury. It is urged that the Trial Court was clearly warranted in submitting the question of appellant's guilt or innocence to the jury, and further that the quantum of uncontradicted evidence is sufficient to sustain the verdict on all counts.

CONCLUSION

The appellee respectfully submits that the appellant was not prejudiced by any occurrence at the trial and that he was convicted on substantial evidence. Hence the verdict of the jury and the judgment of the court below should be sustained.

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IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

AVALO ALLISON FISHER,

Appellant

VS.

UNITED STATES OF AMERICA,

Appellee

PETITION FOR REHEARING *EN BANC*

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IN THE
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AVALO ALLISON FISHER,

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PETITION FOR REHEARING *EN BANC*

To: THE HONORABLE JUDGES OF THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT.

COMES NOW the Appellee by its attorney, the
United States Attorney, and moves this Court to per-
mit a rehearing before the Court *en banc*.

In support thereof, the following is respectfully
submitted:

(1) The Court has been granted by statute the power to order re-hearings en banc and “the discretion for its exercise,” 28 U.S.C., Sec. 46(c) (1952); Cir. 9, Rule 23; *Western Pacific Railroad Corp. v. Western Pacific Railroad Co.*, 345 U.S. 247, 259 (1953). It is a “necessary and useful power” in cases “appropriate for consideration by the full court.” *Id.* at 260, 252.

(2) In the case at bar the Court ordered reversal of a judgment of conviction based upon a jury verdict of guilty on the ground that the trial court had erred in excluding certain evidence and in its instructions to the jury. It is submitted that the far-reaching implications arising from the Court’s decision with respect to the adequacy of the trial court’s instructions to the jury are of such a nature as to warrant consideration by the full Court.

(3) In the opinion of the Court, the trial court’s instruction to the jury as to the meaning of the term “membership” was insufficient for the reason that the dictionary definition read to the jury defined “membership” in terms of its synonyms rather than breaking it down into its component elements (p. 12, Slip Opinion).

It is respectfully submitted that the court has misconceived the true character of the trial court’s instruction. Nowhere in the definition given to the jury

was any synonym for the word "membership" employed, but, on the contrary, the instruction was one which clearly goes to the elements of membership.

The court's charge to the jury afforded a definite standard of guilt and did not render the statute vague and indefinite. Appellant's contention that the word "member" is not sufficiently clear for the jury to have determined his status as a member of the Communist Party is without substance. The word "member" is a word of common knowledge and when related to an organization imputes its own definite meaning. The trial judge informed the jury with specificity as to what their findings would have to be in order to convict appellant of Counts I, III and V of the indictment (R. 849-851), stating as to Count I that they must find that the appellant was a member of the Communist Party as of June 29, 1951; that the statement that he was not then a member of the Communist Party was false, and that appellant used the document containing that statement knowing it to be false and knowing that he was in fact at that time a member of the Communist Party (R. 850). The jury was instructed that the essential elements of Counts III and V were the same, except as to the dates in question. (R. 851).

Membership in an organization is one of the most

commonplace and frequently exercised privileges of today's American citizens. It cannot be reasonably argued that the mentality of members of the jury is such that they are unable to understand the meaning of the word. Nor can it be said that the word "member" is such that each juror must have applied a different subjective test in ascertaining its meaning. Common sense impels the conclusion that each member of the jury applied the established meaning in his deliberation.

In the case of *United States v. Lattimore* (C.A. D.C.) 215 F. 2d, 847, the Court of Appeals held that the word "Communist" has a generic meaning, stating at p. 853:

" * * * It may be true that the word 'Communist' may be used with different shades, gradations or variations of meaning, but all such are within a clearly established generic meaning. The word is not without a meaning which can be used with mutual understanding by a questioner and an answerer."

Surely if the word "Communist" standing alone is not vague, it cannot be said that the more definitive phrase "member of the Communist Party" would have been subject to a divergence of interpretation by the jury.

When Congress enacted the Labor Management Relations Act, 1947, it did not undertake to define

the term "membership." This is an indication that in the minds of Congress the term "member" was of a sufficiently clear meaning and needed no statutory definition.

The word "member" in usage of contemporary society is such a basic concept that it requires and has no special legal connotation.

The crucial question in this case is whether the instruction was such as to provide a sufficient basis upon which the jury could make a determination whether appellant signed the non-Communist affidavit knowing it to be false. The issue in this case is the knowledge by the appellant that he has falsely denied membership in and affiliation with the Communist Party. The sole question, therefore, is whether the accused was *aware* that he was a member of, or affiliated with the Communist Party, *American Communications Association v. Douds*, 339 U.S. 382, 412-413 (1950), and proof of his membership is not dependent upon a showing of his "support, or even demonstrated knowledge" of the Party's principles. *Galvan v. Press*¹ 347 U.S. 522, 528.

¹ The crux of the Supreme Court's decision in *Galvan v. Press*, supra, was the showing that an alien held membership in the Communist Party "aware that he was [a member of] an organization known as the the Communist Party which operates as a distinct and active political organization, and that he [was such] of his own free will * * *" 347 U.S. 522, 528.

The test in determining the adequacy of the instructions as to "membership" is not whether the jury was given a hard and fast list of "criteria"² against which to measure the existence of membership *vel non* but rather it is whether the trial court properly instructed the jury that they must find that the accused was *knowingly* a member of the Communist Party and that he *knowingly* and *wilfully* lied about his membership. Since the instructions in the case at bar adequately covered these essential elements of the crime charged, it is immaterial that they did not call the jury's attention to various indicia which must necessarily vary from case to case depending upon the evidence.³

² Nor is application of the usual tests of attendance at meetings and payment of dues appropriate in the circumstances of this case when, as Judge Denman has observed in commenting on the sufficiency of the evidence, the government has shown that in the period between 1950 and 1952 "the Communist Party policy was that labor leaders subject to such affidavits could destroy Party cards and neither attend meetings nor pay dues." (p. 14, Slip Opinion)

³ Nor was appellant entitled under any circumstances to have the jury instructed as to the matters which are not in evidence in this case. *Battle v. United States*, 209 U.S. 36, 38 (1908); *Bird v. United States*, 187 U.S. 118, 132. Hence the contention that appellant "might honestly state he was not a member [of the Communist Party] if he had failed to comply with any of the Party's formal requirements for

To attempt to apply a rigid "checkoff list" with unvarying mathematical regularity to each and every case involving proof of membership would result in confusing the jury and unduly emphasizing some portions of the evidence at the expense of others. As the Supreme Court observed in *Perovich v. United States*, 205 U.S. 86 (1907), where an exception was taken to the court's refusal to charge the jury in a murder case that the fact that the victim had not been seen after a certain date did not create a presumption of his death:

" * * * Singling out a single matter and emphasizing it by special instruction as often tends to mislead as to guide a jury. Doubtless the isolated fact that Jaconi had not been seen would not of itself establish the fact of his death. It is only a circumstance which, taken in connection with the other facts in the case, tends to prove the death. It is merely one link in a long chain, and the court is seldom called upon by special instructions to

membership as stated in its constitution" (p. 12, Slip Opinion) is without merit. Appellant failed to offer any evidence as to the constitution of the Communist Party or the existence of formal requirements for membership in the Party. At the close of the trial, in making his record of exceptions to the Court's refusal to charge as requested, appellant's counsel expressly omitted those portions of his requested instructions which were based on the Communist Party constitution, stating at the time that the constitution had not been introduced in evidence (R. 869).

single out any single link in a chain, and affirm either its strength or weakness." [Citing 144 U.S. 408, 433 and 163 U.S. 280, 288].

The principal distinction between the instruction on membership in the case at bar and those upheld on appeal in *Hupman v. United States* (C.A. 6), 219 F. 2d 243, Cert. den. 349 U.S. 953, and *Jencks v. United States* (C.A. 5) 226 F. 2d 540 (Cert. grant. Mar. 5, 1956), is that the court in this case did not tell the jury that in considering whether or not the defendant was a member of the Communist Party they *may* consider certain specified indicia of membership. In the *Hupman* case, the following six indicia were mentioned: (1) whether or not the accused attended Communist Party meetings; (2) whether or not he paid money to the Communist Party; (3) whether or not he took instruction from Communist Party leaders or officers; (4) whether or not he took part in the dissemination or distribution of Communist literature; (5) whether or not he engaged in other conduct consistent with membership in the Communist Party; and (6) all other evidence, either direct or circumstantial, which may bear upon the question of whether or not he was a member of the Communist Party. (Quoted in *Jencks*, Gov. 5th Cr. Br. 74).

In the *Jencks* case the criteria mentioned in the court's instruction to the jury on membership were

(1) whether or not the defendant attended Communist Party meetings; (2) whether or not he held an office in the Communist Party; (3) whether or not he engaged in other conduct consistent only with membership in the Communist Party; and (4) all other evidence, either direct or circumstantial, which bears or may bear upon the question of whether or not he was a member of the Communist Party on the date of his affidavit. (*Jencks* R. 1061).

Disregarding the last two items in both of these instructions as affording merely broad general guides to the jury in its consideration of all the evidence as distinguished from specific indicia of membership, it appears that the only criterion common to the instructions given in both the *Jencks* and *Hupman* cases is that of attendance at Communist Party meetings. To hold that it is necessary that a jury of normal and average intelligence be told specifically that it may take into consideration whether or not the accused attended meetings of the Communist Party in determining whether or not he was a member of that Party would be to make an idle and formalistic ritual of the court's instructions to the jury. That such an instruction would be wholly superfluous in the instant case is obvious in the light of the evidence that appellant not only attended closed Communist Party meetings but also distributed Communist Party literature,

collected Communist Party dues, asked the witness Mores what the Party policy was with respect to non-Communist affidavits and later carried out the duties of a Communist Party district organizer.⁴

Moreover, it should be noted that the enumeration by a trial court of any specific indicia which might be considered by a jury in determining whether or not an accused was a member of the Communist Party, might well be more prejudicial than helpful to a defendant since it would directly invite the jury's attention to circumstances which the Court regards as being of the greatest probative value.

⁴ It should be noted that when appellant made his record of exceptions to the charge as given, as well as the refusal to grant his requested instructions, he failed to assign as one of the grounds the fact that the jury was not provided with certain indicia of membership as was done in the *Jencks* and *Hupman* cases. He therefore failed to protect his record on this point as required by Rule 30 of the Federal Rules of Criminal Procedure and the overwhelming weight of authority in this circuit. *Bateman v. United States*, 212 F. 2d 61, 70 (Cir. 9, 1954); *Benatar v. United States*, 209 F. 2d 734, 743, 744 (Cir. 9, 1954); *Herzog v. United States*, 226 F. 2d 561, 567-570 (Cir. 9, 1955); *Mitchell v. United States*, 213 F. 2d 951, 957 (Cir. 9, 1954); *Kobey v. United States*, 208 F. 2d 583, 588, 597, 598 (Cir. 9, 1953); *Zamloch v. United States*, 193 F. 2d 889, 891-892 (Cir. 9, 1952); *Ziegler v. United States*, 174 F. 2d 439, 447-448 (Cir. 9, 1949 — Cert. den. 338 U.S. 822, 1949).

(4) The arguments set forth supra with regard to the trial court's instructions on membership apply equally to the instruction given the jury as to the meaning of the term "affiliation." As before, the test is whether the jury was provided with a sufficient basis for applying the subjective test of falsity, to-wit, that appellant signed the affidavit knowing it to be false.

The only material difference between the instruction on affiliation in the case at bar and the instructions on affiliation in *United States v. Hupman* and *United States v. Jencks* is that in those cases the juries were charged that: "Affiliation, as used in sub-section (h) of section 159, Title 29 of the U. S. Code, means something less than membership, but more than sympathy * * *" This instruction was omitted here. While this additional refinement of the definition of affiliation appears to have merit, especially when considered as an isolated segment without regard to the charge in its entirety, it is respectfully submitted that it is superfluous and unnecessary inasmuch as the only requirement as a matter of law is that the jury be given clear instructions. It is submitted that the cases of *United States v. Reimer* and *Bridges v. Wixon*, cited by the Court in its Opinion, are not applicable. Those cases involved a statute which dealt generally with

affiliation with organizations advocating overthrow without identifying any particular organization. In the case at bar the statute and indictment specifically name the Communist Party so that knowledge of the Party's aims and purposes is immaterial.

In defining the term "affiliation" for the jury in the case at bar, the trial court gave a reasonable measure or standard by which to determine the defendant's guilt or innocence. The jury was instructed that they must find that appellant connected or associated himself with the Communist Party, that he adopted or brought himself into close connection with the Communist Party, that he had allied himself with the Communist Party. These are clear, unambiguous matters which the jury could and did understand. A showing that appellant was thus affiliated with the Communist Party knowingly and of his own free will meets all requirements under the *Douds* and *Galvan* cases.⁵

⁵ The arguments presented by the Government with respect to membership and affiliation are not at variance with the decisions of this circuit applying dictionary definitions for the purpose of ascertaining the meaning of words of common usage: *U. S. v Schulze*, 253 F. 377, 379-380 (D.C., S.D. Cal., S.D., 1918) ("Support," "favor"); *Schulze v. U. S.*, 259 F. 189, 190 (Cir. 9, 1919) ("Support," "favor," "oppose"), *Wolck v. Weedin*, 58 F. 2d 928, 930 (Cir. 9, 1932) ("affiliation"); *Branch v. Cahill*, 88 F. 2d

(5) In holding that the trial court erred in overruling appellant's motion for the production of the receipts signed by the witness Mores for payments made to him by the Federal Bureau of Investigation during the period of his services as a confidential informant between 1942 and May 1953, the court took the position that the jury was entitled to know whether Mores lied when he stated that these payments were for reimbursement of expenses only and did not include any compensation for his services.

Appellant demanded the production of the F.B.I. receipts on the theory that Mores' testimony was inconsistent and contradictory as to the *amount* of the monies paid him as a confidential informant for the Federal Bureau of Investigation between 1942 and 1953 (R. 329) and also on the theory that they *might* contradict the witness's testimony that the payments were for expenses only (R. 332).

Later in the trial, government counsel represent-

545, 546 (Cir. 9, 1937) ("affiliated"). In like manner the Supreme Court held that ordinary words used in a resolution delineating the jurisdiction of a Congressional committee must be construed in their "commonly accepted sense." *U. S. v. Rumely*, 345 U.S. 41, 47 ("lobbying activities"). And in *Casey v. U. S.*, 191 F. 2d 1, 4 (Cir. 9, 1951) where the jury was given no definition of the term "radio station," this Court held: "Radio stations are in such common use that no definition was needed."

ed to the court that he had been advised by the Federal Bureau of Investigation that Mores had been paid a total of \$10,530 up to May 21, 1953 (R. 365). Defense counsel refused to stipulate that this was the amount paid on the ground that he did not know how much had been paid, having had no opportunity to examine the receipts. Counsel at this point asserted a legal right to examine the receipts *or at least the right to have a tabulation of the sums paid* (R. 366). (Italics supplied)

Thereafter, appellant shifted his ground by taking the extreme position that he would demand the production of each and every receipt indicating a payment to Mores during the period of his activities as an informant for the Federal Bureau of Investigation (R. 367). The trial court ruled that it would be sufficient if the Government supplied a certificate of the payments, holding that appellant was entitled to ascertain the total compensation received by Mores because this was material to the issue of his credibility on the ground of interest. The court stated that the only material question for this purpose was as to the total amount which Mores had been paid, and that the court would not be justified in requiring the disclosure of confidential records of the Federal Bureau of Investigation solely for the purpose of determining this amount (R. 367-369).

The Government subsequently produced a certificate setting forth the payments and this document was marked for identification as Government's Exhibit No. 10 and appellant moved its admission. (R. 748). The certificate was admitted without objection by the Government and appellant thereupon renewed his motion for production and examination of the receipts, which motion the court denied. (R. 749).

Apart from defense counsel's wholesale accusations that Government witnesses were paid to testify, the record contains no reference to any payments to Mores, let alone evidence of such payments, subsequent to those which he had been receiving currently during the period of his services as a confidential informant. The indictment in this case was not returned until June 24, 1954, more than a year after Mores had ceased his activities as a confidential informant. Hence, there is absolutely no basis for any claim or suggestion that Mores was paid anything for his testimony in this case other than the usual and proper witness fees. Nor did appellant's counsel make any attempt during extended cross-examination lasting from four to five hours to lay a foundation for an attack on Mores credibility on the ground that he was being paid for his testimony. No questions were asked of the witness to ascertain whether or not he had received payments from the Government for any purpose

whatsoever subsequent to those made contemporaneously with his activities as a confidential informant. Hence, the record as it stands is completely devoid of any basis for challenging Mores' credibility on the ground of interest based on the supposition that he was being paid for his testimony in this case.

With all due deference, it is respectfully submitted that regardless of the connotation placed on the term expenses by the witness or any other party to the proceeding, the Court's position with respect to the trial court's refusal to order production of the receipts is not well taken. Moreover, it would appear that the Court has given undue weight to the magnitude of the total payments without considering the fact that they continued over a period of 11 years so that the average monthly payments during that time did not amount to more than \$75 per month. Obviously, any compensation received by the witness would have included his disbursements for gasoline, dues, contributions, Party literature and other expenses.

In any event, no foundation was laid for impeachment on the ground that Mores was being paid anything at the time of his testimony at the trial of this case or at any time subsequent to May 1953 or that he was in any way financially interested at the time of the trial. All of the evidence in this case re-

lating to moneys which Mores received from the Federal Bureau of Investigation had to do with past payments in connection with his activities more than 18 months prior to the trial for which no further moneys were due him. It can hardly be supposed that Mores and his wife were seeking evidence in 1943 to support a prosecution of appellant in 1954 arising from a statute which was not enacted until 1947.

Any justification for the theory that the receipts should have been admitted in evidence must necessarily rest upon a showing of their relevance and materiality to the issues of this case. Their materiality, if any, was confined solely to the issue of Mores' credibility. Viewed in this light, it becomes apparent how tenuous is appellant's theory, accepted by the Court, that the receipts were material. For it is obvious that the only way in which they can be linked with the issues in this case would be by showing that the amount and character of the moneys received by Mores as an informant for the F.B.I. had some bearing on the question of his interest as a witness more than a year and a half after he ceased to be an informant. The record does not contain a scintilla of evidence to indicate that Mores had any personal interest in the outcome of this case and no rational consideration of the evidence leaves room for the absurd hypothesis that Mores was engaged by the Government specifically to spy on Fisher as an

individual.⁶ Hence, it can be seen that the "connection" between these payments and the issues before the trial court was indirect and remote in the extreme.

Inasmuch as appellant in the instant case failed to lay the necessary foundation for his demand by showing that the receipts signed by Mores would be contradictory of his present testimony and that the contradiction was as to relevant, important and material matters which directly bore on the main issue being tried, viz: the participation of the accused in the crime, it is obvious that the attempt to secure production of the F.B.I. receipts for the purpose of determining "the method, mode and extent of payment" (R. 333-334) was what the Supreme Court characterized in *Gordon v. United States*, 344 U.S. 414, as a

⁶ The record shows clearly that Mores had been engaged in observing and reporting upon Communist Party activities and personalities generally, and the fact that certain activities of appellant were included was merely incidental to the performance of these duties. Cf. *Jencks v. United States*, 226 F. 2d 540, 553, where the Court of Appeals for the Fifth Circuit observed: "* * * Appellant dwells upon his accusation that these informers were 'involved in despicably dirty business of informing for pay; and takes the prosecution to task for its reliance upon the testimony of such witnesses. The answer to that argument is, of course, that the Government has nothing to do with selecting the witnesses. The witnesses against appellant were determined when appellant chose those with whom he would fraternize.'"

blind fishing expedition. Indeed, appellant himself admitted this to be the case when he conceded that he did not know whether the receipts would contradict the witness, but merely hoped that something impeaching might turn up.

The rule laid down in the *Gordon* case was quoted with approval by this Court in *Herzog v. United States*, 226 F. 2d, 561, (Cir. 9, 1955) holding that no foundation was laid for a demand for the production of a transcript of the testimony of certain Government witnesses before a grand jury. The Court distinguished the numerous cases cited by the appellant in that case stating at page 566:

“Other than the *Alper* case, the cases cited by appellant all deal with statements given by a witness to Government agents rather than testimony before a grand jury. None of the cases suggests that grand jury testimony or statements in Government reports should be turned over to the defendant to inspect for possible impeachment material without some prior showing that statements contradictory to the witness’s testimony at trial are contained therein.”

Another Government witness in the *Herzog* case testified that the defendant requested him to make payments for used cars purchased from the defendant partly by check and partly in cash, inasmuch as the defendant was going to show only a portion of his selling price on his invoices. On cross-examination this

witness was asked if he himself had been in difficulties with the O.P.A. at the time in question. He replied in the negative. Subsequently, the defendant proffered in evidence for purposes of impeachment an entry in the witness's books showing a disbursement for attorneys' fees in connection with a threatened O.P.A. suit. In holding that the trial court properly excluded this evidence, this Court commented as follows:

“ * * * The trial court's ruling was correct. McNeil's O.P.A. difficulties, if any, were not an issue in this case. The purpose of evidence is to prove or disprove some issue in the cause on trial. If proffered evidence does not tend to do either of these things, it has no place in the trial and is either immaterial or collateral to the inquiry. A witness cannot be impeached where the subject matter of his testimony is either immaterial or collateral to the issues in the cause in which the testimony is given. *Arine v. United States*, 9 Cir., 10 F. 2d 778; *Shanahan v. Southern Pacific Co.*, 9 Cir., 188 F. 2d 564.” 226 F. 2d 561, 565.

(6) This Court held that the trial court erred in not allowing appellant to cross-examine the witness Harper concerning proceedings before a Security Board in which Harper had previously appeared as a witness (p. 8, Slip Opinion, R. 522). It is respectfully submitted, however, that the trial court properly refused to permit appellant to cross-examine Harper relative to his testimony in a collateral matter. Appellant represented to the trial court that on two occa-

sions during the hearings in question Harper had mistakenly identified other persons as being the individual whose case was being heard. Appellant further asserted that Harper had subsequently failed to identify the correct individual (R. 518-521).

In its opinion, this Court noted that the Government relied upon the rule in *Shanahan v. Southern Pacific Co.*, 188 F. 2d 564 (Cir. 9, 1951) that a witness cannot be impeached by an inconsistent statement on a collateral matter. Nevertheless, for the reasons stated below, the Court concluded that the trial court's exclusion of this evidence was error:

“However, appellant's theory was that Harper had been presented to the jury as an ‘expert’ on Communism, Communist activity and on identification of Communists. He wanted to challenge Harper's expert standing and show bias in that Harper was paid to produce his testimony. Harper's testimony placing appellant at a closed meeting of the Communist Party in 1949 was a critical part of the Government's case.⁷ Great latitude in cross-examination should be allowed. We hold the court erred in refusing it. See *United*

⁷ Although proof of appellant's attendance at a closed meeting of the Communist Party in 1949 undoubtedly contributed to the strength of the Government's case, Harper's testimony in this regard was merely cumulative. As the court indicated in holding the evidence sufficient to sustain the verdict, Mores also testified that appellant attended this meeting. (p. 14, Slip Opinion).

States v. Augustine, 189 F. 2d 587, 590-591⁸ (Cir. 3, 1951)." (p. 8, Slip Opinion).

It is respectfully submitted that while Harper may have been presented to the jury as an expert on Communist Party policy, he definitely was *not* presented or qualified as an expert on the identification of individuals. The trial court so ruled and appellant himself expressly conceded the point during the following colloquy at page 489 of the record:

⁸ In *United States v. Augustine*, *supra*, cited in the Court's opinion, the Court of Appeals for the Third Circuit upheld a ruling limiting the scope of cross-examination of one government witness, but reversed on the ground that the court had unduly restricted the cross-examination of another witness. In the first instance the appellate court found that there had been no abuse in the exercise of the trial court's broad discretion in setting limits upon the extent of cross-examination as to the issue of credibility. As to the second witness, the court held "with reluctance" that further cross-examination should have been permitted because the testimony of this individual, who was called as a rebuttal witness by the prosecution, tended strongly to discredit the testimony given by the accused in his defense. The trial court refused to permit inquiry into matters material to the credibility of the witness although the facts stated in the opinion strongly suggested the possibility of a direct financial motive for falsehood in the witness's testimony bearing on the main issue in the case. 189 F. 2d 587, 590-591. The factual situation insofar as the second witness was concerned is therefore distinguishable from the case at bar.

“MR. ETTER: It is my understanding he has been qualified as an expert.

THE COURT: *Not as an expert in identification.* (Italics supplied).

MR. ETTER: No, no; that is right. As I gather your Honor’s ruling, the objection will be sustained, however?

THE COURT: Yes; however you can make your record.”

The theory that Harper became clothed with the mantle of an “expert” as to *all* matters about which he testified was concocted by appellant at the trial in the effort to justify his attempted inquiry into a wholly collateral matter. This was in reality merely an attempt to impeach Harper’s credibility under the guise of an attack on his “qualifications” as an “expert witness.” (R. 488-489). As already noted, the court rejected this spurious argument and appellant himself conceded its invalidity. (R. 489).

For the foregoing reasons it is respectfully suggested that the court’s discretion would most appropriately be exercised by the order for the rehearing *en banc*.

Inasmuch as the Supreme Court has seen fit to grant a petition for a writ of certiorari to review the judgment of the Court of Appeals for the 5th Circuit in *Jencks v. United States*, 226 F. 2d 540 and 226 F.

2d 553 (Cir. 5, 1955), involving issues somewhat analogous to those presented in the case at bar, it is respectfully suggested that if the court is not disposed to grant this petition for a rehearing, the court may wish, nevertheless, to withhold its decision on the petition pending the illumination of the issues by the Supreme Court in the *Jencks* case.

CHARLES P. MORIARTY
United States Attorney

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Attorney, Department of Justice

BRANDON ALVEY
Attorney, Department of Justice

CLINTON B. D. BROWN
Attorney, Department of Justice

CERTIFICATE OF GOOD FAITH

It is hereby certified that the petition is presented in good faith and not for delay.

CHARLES P. MORIARTY
United States Attorney

No. 14732

United States
Court of Appeals
for the Ninth Circuit

PACIFIC HOMES, INC., a Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

FILED

SEP - 9 1955

PAUL P. O'BRIEN, CLERK

No. 14732

**United States
Court of Appeals**
for the Ninth Circuit

PACIFIC HOMES, INC., a Corporation,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

Transcript of Record

**Appeal from the United States District Court for the
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the Southern Division of the United States
District Court, Northern District of California

No. 31368

PACIFIC HOMES, INC., a California Corpora-
tion,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT TO RECOVER TAXES PAID

Plaintiff respectfully alleges as follows:

First Claim for Relief

I.

Plaintiff is a corporation duly organized and existing under and by virtue of the Laws of the State of California and is a resident of the Southern Division of the Northern Judicial District of California. Plaintiff was dissolved in the calendar year 1947, and on or about April 30, 1947, distributed all of its then known assets to its sole stockholder. Plaintiff prosecutes this action by reason of the authority contained in rule 17(b) of the Federal Rules of Civil Procedure, and by reason of the provisions of sections 5400, 5401 and 5402 of the California Corporations Code, which said last mentioned sections provide in substance and effect that a corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting

and defending actions by or against, it, and enabling it to collect and discharge obligations and collect and divide its assets, and that any assets inadvertently or otherwise omitted from the winding up continue in the dissolved corporation for the benefit of the persons entitled thereto upon dissolution of the corporation.

II.

James G. Smyth was the duly appointed, qualified and acting Collector of Internal Revenue for the First District of California at all times during the period from May 14, 1945, to and including September 27, 1951. Said James G. Smyth is not now in office as Collector of Internal Revenue. All amounts of United States Internal Revenue Taxes for the recovery of which suit is filed herewith were erroneously or illegally collected from plaintiff by defendant through said James G. Smyth as such Collector of Internal Revenue. All corporation tax returns hereinafter alleged to have been filed with defendant were filed with defendant through said James G. Smyth as such Collector of Internal Revenue.

III.

This is a cause of actual controversy of a civil nature arising under a law of the United States providing for internal revenue, to wit, the "Internal Revenue Code," enacted on February 10, 1939, as Public No. 1, 76th Congress, 1st sess. C. 2, 53 Stat. 1, as amended (Title 26, U.S.C.A., sections 1, et seq., as amended).

IV.

Jurisdiction is conferred by Title 28, U.S.C.A., sections 1340 and 1346.

V.

Plaintiff was incorporated under the laws of the State of California on August 9, 1941, and thereafter duly adopted a fiscal year ending on the 31st day of May of each year for the purpose of closing its accounts and filing its tax returns. Plaintiff at all times herein mentioned maintained and closed its books on the accrual method of accounting and at all times herein mentioned plaintiff filed its Federal Corporation Income and Federal Corporation Excess Profits Tax returns on the accrual basis.

VI.

During the fiscal year ended May 31, 1946, plaintiff sold certain personal property and also certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land, houses and personal property sold by plaintiff as herein in this paragraph VI alleged, had been held by plaintiff for rental and investment purposes more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real and personal property so held for more than six months, a gain of \$327,268.85.

VII.

In addition to the real and personal property sold by plaintiff, as more particularly described in para-

graph VI hereof, plaintiff, during the fiscal year ended May 31, 1946, also sold 39 parcels of improved real property, none of which had been held by plaintiff for six months preceding their respective sales. Plaintiff sustained a loss of \$9,561.66 from the sale of said 39 parcels.

VIII.

The sum of \$317,707.19, representing the excess of the gain on the sales of the property described in paragraph VI hereof, over the loss on the sales of the improved real property described in paragraph VII hereof, constitutes a long-term capital gain which is not subject to United States Excess Profits Tax for the fiscal year ended May 31, 1946, by reason of the provisions contained in section 711 of the Internal Revenue Code. Said gain of \$317,707.19 constitutes gain from the sale of "Capital Assets," as provided by section 117 of the Internal Revenue Code.

IX.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1946, and reported therein as net long-term capital gains the net gains reported on the sales of the real and personal property referred to in paragraphs VI and VII hereof. Plaintiff paid to defendant all of the federal corporation income and excess profits taxes shown to be due on its said returns so filed, as aforesaid, for the fiscal year ended May 31, 1946. Thereafter, a deficiency of \$111,151.11 was determined,

with respect to federal corporation excess profits taxes, due from the plaintiff for the fiscal year ended May 31, 1946, and said sum of \$111,151.11, together with interest thereon at 6% per annum from August 15, 1946, was paid to defendant on or about February 3, 1948. Said deficiency of \$111,151.11 and interest thereon, was determined by including as subject to United States Federal Excess Profits tax for the fiscal year ended May 31, 1946, the net gain of \$317,707.19 more particularly described in paragraph VIII hereof.

X.

Within two years from the date of the payment of said sum of \$111,151.11 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, "Claim" a claim for refund of said sum of \$111,151.11, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said net gain of \$317,707.19 described in paragraph VIII hereof, represented the excess of the plaintiff's long-term capital gain over the plaintiff's short-term capital loss and, that accordingly, plaintiff had no Excess Profits Tax liability for the fiscal year ended May 31, 1946.

XI.

On or about the 21st day of March, 1950, said claim so filed by plaintiff, as alleged in paragraph X hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner,

on or about the 21st day of March, 1950, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Second Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1947, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said real property sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months a gain of \$66,808.36.

III.

Said sum of \$66,808.36 representing the gain on the sales of said real property described in paragraph II hereof, constitutes a long-term capital gain

and not ordinary income, for the fiscal year ended May 31, 1947, as provided by section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its Federal Income Tax Return with defendant for the fiscal year ended May 31, 1947, and reported therein as capital gains the gains reported on the sales of the real property referred to in paragraph II hereof. Plaintiff paid to defendant all of the Federal Corporation Income Taxes shown to be due on its said return so filed for the fiscal year ended May 31, 1947. Thereafter, a deficiency in the amount of \$7,083.47 was determined with respect to federal corporation income taxes due from plaintiff, and said sum of \$7,083.47, together with interest thereon at 6% per annum from August 15, 1947, was paid to defendant on or about February 3, 1948. Said deficiency of \$7,083.47 and interest thereon, was determined by including as subject to United States Federal Income Tax at ordinary rates and not at capital gain rates, the gain of \$66,808.36, more particularly described in paragraph III hereof.

V.

Within two years from the date of the payment of said sum of \$7,083.47 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, "Claim," a claim for refund

of said sum of \$7,083.47, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$66,808.36 was properly reported by plaintiff on its Federal Corporation Income Tax Return as long-term capital gain and that said sum was not taxable as ordinary income.

VI.

As a result of deficiencies alleged to be due from plaintiff for additional federal income and excess profits taxes for fiscal years ended prior to May 31, 1947, plaintiff paid interest on or about February 3, 1948, to defendant in the amount of \$6,618.55, said interest being applicable to fiscal years ended May 31, 1945, and May 31, 1946. Said sum of \$6,618.55 represents an interest accrual to and including April 30, 1947, and is an allowable deduction in the computation of plaintiff's federal income and excess profits tax liability for the fiscal year ended May 31, 1947. The amount of refund of federal income and excess profits taxes due to plaintiff applicable to said interest payment of \$6,618.55 is the sum of \$2,515.04, all as more particularly alleged and set forth in Treasury Department Form 843, Claim, heretofore filed by plaintiff, as alleged in paragraph V hereof.

VII.

On or about the 21st day of March, 1950, said claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 21st day of March, 1950, gave notice in

writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Third Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV, and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land and houses sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months, a gain of \$76,040.80, of which amount \$7,272.83 represented unrealized profits on installment sales which were deferred to future years, leaving a net gain applicable to the fiscal year ended May 31, 1945, of \$68,767.97. In addition to said net gain of \$68,767.97, plaintiff during the fiscal year ended May 31, 1945, sold an unimproved parcel of real property which had been held by

plaintiff for investment for more than six months at the time of its sale, and plaintiff realized from said sale a gain of \$424.21.

III.

The sum of \$69,192.18, representing the aggregate gain from the sale of improved and unimproved real property, more particularly described in paragraph II hereof, constitutes long-term capital gain which is not subject to United States excess profits tax for the fiscal year ended May 31, 1945, by reason of the provisions contained in section 711 of the Internal Revenue Code. Said gain of \$69,192.18 constitutes gain from the sale of "capital assets," as provided by section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1945, and reported therein, as long-term capital gains, the sum of \$69,192.18, representing net gains reported on sales of said real property described in paragraphs II and III hereof. Plaintiff paid to defendant all of the federal income and excess profits taxes shown to be due on its said returns so filed as aforesaid, for the fiscal year ended May 31, 1945. Thereafter, a deficiency of \$18,741.37 was determined with respect to federal corporation excess profits taxes due from plaintiff for the fiscal year ended May 31, 1945, and said sum of \$18,741.37, together with interest thereon at 6% per annum from August 15,

1945, was paid to defendant on or about February 3, 1948. Said deficiency of \$18,741.37 and interest thereon was determined by including, as subject to United States federal excess profits tax, the gain of \$69,192.18 more particularly described in paragraphs II and III hereof.

V.

Within two years from the date of the payment of said sum of \$18,741.37 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, Claim, a claim for refund of said sum of \$18,741.37, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$69,192.18 represented a long-term capital gain and that, accordingly, plaintiff had no excess profits tax liability for the fiscal year ended May 31, 1945.

VI.

On or about the 6th day of February, 1951, said Claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 6th day of February, 1951, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Fourth Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land and houses sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months a gain of \$76,040.80, of which amount \$7,272.83 represented unrealized profits on installment sales which were deferred to future years, leaving a net gain applicable to the fiscal year ended May 31, 1945, of \$68,767.97. In addition to said net gain of \$68,767.97, plaintiff, during the fiscal year ended May 31, 1945, sold an unimproved parcel of real property which had been held by plaintiff for investment for more than six months at the time of its sale, and plaintiff realized from said sale a gain of \$424.21.

III.

The sum of \$69,192.18, representing the aggregate gain from the sale of improved and unimproved real property more particularly described in paragraph II hereof, constitutes long-term capital gain and does not constitute ordinary income subject to tax as provided in the United States Internal Revenue Code. Said gain of \$69,192.18 constitutes gain from the sale of "capital assets" as provided in section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1945, and reported therein as long-term capital gains the sum of \$69,192.18, representing net gains reported on the sales of real property referred to in paragraphs II and III hereof. Plaintiff paid to defendant all of the federal corporation income and excess profits taxes shown to be due on said returns so filed as aforesaid, for the fiscal year ended May 31, 1945. Thereafter, a deficiency of \$4,065.53 was determined with respect to the federal corporation income tax due from plaintiff for the fiscal year ended May 31, 1945, and said sum of \$4,065.53, together with interest thereon at 6% per annum from August 15, 1945, was paid to defendant on or about February 3, 1948. Said deficiency of \$4,065.53 and interest thereon was determined by including as subject to United States corporation income tax at ordinary

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rates and not as long-term capital gain, the said gain of \$69,192.18, more particularly described in paragraph III hereof.

V.

Within two years from the date of the payment of said sum of \$4,065.53 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly and in the manner provided by law, filed with defendant, in writing, on Treasury Department Form 843, Claim, a claim for refund of said sum of \$4,065.53, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$69,192.18 represented long-term capital gain taxable as provided in section 117 of the United States Internal Revenue Code and not taxable as ordinary income.

VI.

On or about the 15th day of May, 1950, said claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 15th day of May, 1950, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as follows:

1. For the sum of \$111,151.11, together with interest thereon at 6% per annum from August 15, 1946; and

2. For the sum of \$7,083.47, together with in-

terest thereon at 6% per annum from August 15, 1947; and

3. For the sum of \$18,741.37; together with interest thereon at 6% per annum from August 15, 1945; and

4. For the sum of \$4,065.53, together with interest thereon at 6% per annum from August 15, 1945; and

5. For plaintiff's costs incurred herein; and

6. For such other and further relief as to this Court may seem proper in the premises.

/s/ L. W. WRIXON,
Attorney for Plaintiff.

[Endorsed]: Filed March 19, 1952.

[Title of District Court and Cause.]

ANSWER

Comes Now the United States of America, defendant herein, by and through Chauncey Tramutolo, United States Attorney in and for the Northern District of California, and for its answer to the complaint filed in the above-entitled action, alleges and says as follows:

First Claim for Relief

1. Defendant admits the allegations contained in paragraph I of plaintiff's first claim for relief.

2. Defendant denies that any United States internal revenue taxes, for the recovery of which the above-entitled action is filed, were erroneously or illegally collected. Defendant admits the remaining allegations contained in paragraph II of the plaintiff's first claim for relief.

3. Defendant admits the allegations contained in paragraph III of plaintiff's first claim for relief.

4. Defendant admits the allegations contained in paragraph IV of plaintiff's first claim for relief.

5. Defendant admits the allegations contained in paragraph V of the plaintiff's first claim for relief.

6. Defendant denies the allegations contained in paragraph VI of plaintiff's first claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1946, plaintiff sold certain personal property and also certain real property consisting of land and houses.

(b) That plaintiff realized from the sales of the said real and personal property a gain of \$327,268.85.

7. Defendant admits the allegations contained in paragraph VII of plaintiff's first claim for relief.

8. Defendant denies the allegations contained in paragraph VIII of the plaintiff's first claim for relief.

9. Defendant admits the allegations contained in

paragraph IX of plaintiff's first claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, April 21 (by credit application), May 19 and September 13, 1948.

10. Defendant admits the allegations contained in paragraph X of plaintiff's first claim for relief.

11. Defendant admits the allegations contained in paragraph XI of the plaintiff's first claim for relief.

Second Claim for Relief

12. Defendant's answer to paragraph I of plaintiff's second claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

13. Defendant denies the allegations contained in paragraph II of plaintiff's second claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1947, plaintiff sold certain real property consisting of land and houses.

(b) That plaintiff realized from the sale of said real property a gain of \$66,808.36.

14. Defendant denies the allegations contained in paragraph III of plaintiff's second claim for relief.

15. Defendant admits the allegations contained in paragraph IV of plaintiff's second claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, 1948, and April 21, 1948 (by credit application).

16. Defendant admits the allegations contained in paragraph V of plaintiff's second claim for relief.

17. Defendant denies the allegations contained in paragraph VI of plaintiff's second claim for relief.

18. Defendant admits the allegations contained in paragraph VII of plaintiff's second claim for relief.

Third Claim for Relief

19. Defendant's answer to paragraph I of plaintiff's third claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

20. Defendant denies the allegations contained in paragraph II of plaintiff's third claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses.

(b) That plaintiff realized from the sale of said real property a net gain of \$68,767.97, applicable to the fiscal year ended May 31, 1945.

(c) That during the fiscal year ended May 31, 1945, plaintiff sold an unimproved parcel of real property.

(d) That plaintiff realized from the sale of said unimproved parcel of real property a gain of \$424.21.

21. Defendant denies the allegations contained in paragraph III of plaintiff's third claim for relief.

22. Defendant admits the allegations contained in paragraph IV of plaintiff's third claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, 1948, and on April 21, 1948 (by credit application).

23. Defendant admits the allegations contained in paragraph V of plaintiff's third claim for relief.

24. Defendant admits the allegations contained in paragraph VI of plaintiff's third claim for relief.

Fourth Claim for Relief

25. Defendant's answer to paragraph I of plaintiff's fourth claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

26. Defendant denies the allegations contained in paragraph II of the plaintiff's fourth claim for relief except that it admits the following:

(a) That during the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses.

(b) That plaintiff realized from the sale of said real property a net gain of \$68,767.97, applicable to the fiscal year ended May 31, 1945.

(c) That during the fiscal year ended May 31, 1945, plaintiff sold an unimproved parcel of real property.

(d) That plaintiff realized from the sale of said unimproved parcel of real property a gain of \$424.21.

27. Defendant denies the allegations contained in paragraph III of plaintiff's fourth claim for relief.

28. Defendant admits the allegations contained in paragraph IV of plaintiff's fourth claim for relief, except that it denies that the deficiency determined with respect to the Federal corporation income tax due from plaintiff for the fiscal year ended May 31, 1945, was \$4,065.53, and alleges said deficiency was \$3,622.99; and defendant denies that plaintiff paid the sum of \$4,065.53 on February 3, 1948, with interest, but alleges that it paid the aggregate sum of \$3,622.99, with interest thereon, on the dates of February 4, 1948, and on April 21, 1948 (by credit application).

29. Defendant admits the allegations contained in paragraph V of plaintiff's fourth claim for relief, except that it denies that plaintiff paid the sum of \$4,065.53, with interest thereon, as a deficiency in corporation income taxes for the fiscal year ended May 31, 1945, but alleges that the amount of said deficiency paid by plaintiff was \$3,622.99.

30. Defendant admits the allegations contained in paragraph VI of plaintiff's fourth claim for relief.

Wherefore, defendant demands judgment against plaintiff and costs.

/s/ CHAUNCEY TRAMUTOLO,
United States Attorney.

[Endorsed]: Filed October 15, 1952.

[Title of District Court and Cause.]

STIPULATION

The parties to this action, through their respective counsel, hereby stipulate that the following facts are true:

1. Pacific Homes, Inc., the plaintiff herein (hereinafter sometimes referred to as "Pacific"), is a dissolved corporation. Pacific was incorporated under the laws of the State of California on August 9, 1941, under the name of "Emergency Houses Corporation." The corporate name was, on December 22, 1941, changed to "Pacific Coast Homes, Inc.,"

and on January 30, 1942, the corporate name was changed to "Pacific Homes, Inc."

2. On November 12, 1946, a "Certificate of Election of Pacific Homes, Inc., to Wind Up and Dissolve" was filed with the Secretary of State of the State of California. On May 31, 1947, a "Certificate of Dissolution of Pacific Homes, Inc., a California corporation," was filed with the Secretary of State of the State of California.

3. The only shares of stock issued by Pacific were 50 shares of common stock issued for cash, at \$100.00 per share, on February 5, 1942—26 shares to David D. Bohannon and 24 shares to R. H. Chamberlain.

4. On January 4, 1945, the Board of Directors of Pacific authorized the purchase from David D. Bohannon of his 26 shares for \$16,647.00. The purchase of said 26 shares was consummated on May 10, 1945. Ross H. Chamberlain owned said 24 shares of Pacific from date of issuance on February 5, 1942, until the corporation was finally and formally dissolved, as set forth in paragraphs 1 and 2 hereof.

5. Mr. Ross H. Chamberlain was one of the three incorporators of Pacific. Mr. David D. Bohannon was a Director and President of Pacific continuously from January 30, 1942, until January 4, 1945. Mr. Ross H. Chamberlain was a Director and Secretary-Treasurer of Pacific continuously from January 30, 1942, until January 4, 1945. Mr. Ross H. Chamberlain was a Director and President of Pacific continuously from January 4, 1945, until Pacific was

finally and formally dissolved, as set forth in paragraphs 1 and 2 hereof.

6. Pacific filed the following listed six applications for priorities on Form PD105. Each of said applications was for a preference rating to obtain materials which were required to construct single family defense housing dwellings. Each of said applications was granted. Said applications may be summarized by tracts as follows:

Name of Tract	No. of Houses
Homewood	206
Dec. 31, 1941	175 houses
April 6, 1942	31 houses
Southwood	
July 13, 1943	72
Shoreview	63
May 29, 1943	51 houses
July 7, 1943	9 houses
Oct. 26, 1943	3 houses

With the exception of application dated December 31, 1941, relating to 175 houses in the Homewood Tract, all of said applications stated that the houses were to be built to rent. Said application dated December 31, 1941, stated the houses were to be built for sale. Shortly before March 8, 1943, Pacific ad-

*Although the priority applications filed with respect to the Homewood Tract covered only 206 houses, 212 houses were in fact built in the Homewood Tract.

addressed a letter to the Federal Housing Administration relating to said December 31, 1941, application concerning 175 houses, said letter reading in part as follows:

“All of the above houses are completed and occupied on the rental option plan. Although the original application was for the purpose of sale, we proceeded on the rental option basis and have given all occupants option to purchase.”

(A copy of said letter is attached, marked Exhibit 1.)

Plaintiff agrees to have available at the trial, the original of each of said applications bearing the approval of the appropriate Government agencies. No objection will be made by either party to an offer of same into evidence by a party thereto.

7. Attached hereto and marked Exhibits No. 2, 3 and 4, are the following listed statements which summarize Pacific’s financial and operating results relating to the ownership, rental and sale of houses for the period from its organization to April 30, 1947, the date as of which its then remaining assets were transferred to Ross H. Chamberlain, its sole shareholder. Said exhibits 2, 3 and 4 may be summarized as follows:

Statement	Exhibit No.
(a) Rents received, June 1, 1942, to April 30, 1947	2
(b) Profit from Real Property Sales, June 1, 1942, to April 30, 1947.....	3

- (c) Investment in Real Property and notes and mortgages secured thereby, payable as of the close of each fiscal year from May 31, 1942, to May 31, 1946, inclusive 4

8. Exhibits 5, 6 and 7 attached hereto are correct statements of the facts therein set forth concerning the acquisition, rental and sale by Pacific of Houses at its Homewood, Southwood and Shoreview Tracts.

9. The original or a copy of each of the following listed tax returns filed on behalf of Pacific, namely, Form 1120, United States Corporation Income and Declared Value Excess Profits Tax Returns, and Form 1121, United States Corporation Excess Profits Tax Returns, will be made available by defendant at the trial, and no objection will be made by either party to an offer of same into evidence by a party hereto:

(a) Form 1120 for fiscal year ended May 31, 1947;

(b) Forms 1120 and 1121 for fiscal year ended May 31, 1946;

(c) Forms 1120 and 1121 for fiscal year ended May 31, 1945.

10. The parties agree that a copy of the Report of Revenue Agent E. Brenton, dated December 1, 1947, relating to the examination of the Federal Tax Returns listed in paragraph 9 hereof will be made available at the trial, and no objection will

be made by either party to an offer of same into evidence by a party hereto.

11. The houses built in the Homewood, Southwood and Shoreview Tracts referred to in paragraph 6 hereof, were constructed in areas which were designated as critical war effort areas in which there existed a manpower shortage and inadequate housing.

12. None of the houses in the Southwood and Shoreview Tracts was leased with an option in the tenant to purchase the property. Houses in the Homewood Tract were initially leased under terms which granted the tenants a 30-month option to purchase the property.

13. The houses authorized to be constructed pursuant to the priority applications referred to in paragraph 6 hereof were constructed under a Federal Housing Administration Title VI Loan made by various banks to Pacific. A separate loan was made by the lending institution on each house, and a separate promissory note and deed of trust were executed by Pacific for each such loan. As a condition to the granting of such loans, Ross H. Chamberlain and David D. Bohannon were required to and did individually and personally guarantee each loan made by the lending institution on each individual house until such house was completed and the loan became fully insured by the Federal Housing Administration.

14. During the three fiscal years which are involved in this suit, to wit, the fiscal years ended May

31, 1945; May 31, 1946, and May 31, 1947, Pacific sold the houses set forth in Exhibits 5, 6 and 7 attached hereto. Each of the said houses sold during said three fiscal years was held by Pacific for a period of more than six months prior to the date of sale. Seven houses in the Shoreview Tract shown on Exhibit 7 were sold during a prior fiscal year, to wit, the fiscal year ended May 31, 1944, without being held by Pacific for a period of six months prior to the dates of sale.

15. In the event the Court orders judgment be rendered for plaintiff that the gain realized from the sale of some or all of the houses held by Pacific for more than six months be taxed as long-term capital gain, instead of as ordinary income, and the parties hereto are unable to agree upon the principal amount of the judgment and/or the amount of interest to be added thereto, each of the parties, subject to such order as the court may prescribe, shall have the right to offer such additional evidence as may be pertinent to a determination of the amount of such judgment and any interest thereon.

Dated: December 13th, 1954.

/s/ L. W. WRIXON,

/s/ CARL R. SCHULZ,

Attorneys for Plaintiff.

LLOYD H. BURKE,

United States Attorney;

By /s/ GEORGE A. BLACKSTONE,

Assistant United States Attorney, Attorneys for
Defendant.

EXHIBIT No. 1

Mr. D. C. McGinness, District Director,
Federal Housing Administration,
315 Montgomery Street,
San Francisco, California.

Re: Priorities Case No. 77-121-000866-Serial
No. 1731.

Dear Mr. McGinness:

No. Units: 175.

No. Rooms: 5 (2 Bedrooms).

Total Payment Per Mo. During Option Period:
\$45.00.

Agreed Sales Price: (24) \$4,100, (151) \$4,000.

Length Option. 30 Mos.

The above application was filed under date of
December 31, 1941.

All of the above houses are completed and occupied on the rental option plan. Although the original application was for the purpose of sale, we proceeded on the rental option basis and have given all occupants option to purchase. We now discover in our original application a sales price was set at \$3,675. This obviously was an error as we did not vary from our original estimates of cost and sales price. The price set forth in the option given

to tenants is \$4,100 for 24 of the units and \$4,000 for the balance of 151 units. The F.H.A. commitment on the 24 units is \$3,700 and on the 151 units \$3,600. The total monthly payment on all of the units is \$4,500 per month each.

We will appreciate the approval of the sales price as originally intended as above set forth.

Very truly yours,

PACIFIC HOMES, INC.,

D. D. BOHANNON,
President.

DDB:RW

EXHIBIT No. 2

Pacife Homes, Inc.

Rents Received

(Organization to liquidation of the company)

		June 1/42 to May 31/43	June 1/43 to May 31/44	June 1/44 to May 31/45	June 1/45 to May 31/46	June 1/46 to Apr. 30/47
Homewood Tract:	Total					
Gross rentals	\$315,791.86	\$ 83,480.81	\$109,011.97	\$ 94,085.78	\$ 28,585.50	\$ 627.80
Expenses	250,501.18	69,243.58	81,832.58	75,184.89	23,736.77	503.36
Net rental income..	\$ 65,290.68	\$ 14,237.23	\$ 27,179.39	\$ 18,900.89	\$ 4,848.73	\$ 124.44
Southwood Tract:						
Gross rentals	\$ 81,272.05		\$ 11,961.32	\$ 42,945.16	\$ 26,430.60	\$ (65.03)
Expenses	67,995.25		9,716.85	34,516.12	23,551.86	210.42
Net rental income..	\$ 13,276.80		\$ 2,244.47	\$ 8,429.04	\$ 2,878.74	\$ (275.45)
Shoreview Tract:						
Gross rentals	\$ 65,811.12		\$ 14,590.08	\$ 32,645.63	\$ 18,460.41	\$ 115.00
Expenses	55,968.48		13,484.55	26,600.82	15,767.23	115.88
Net rental income..	\$ 9,842.64		\$ 1,105.53	\$ 6,044.81	\$ 2,693.18	\$ (.88)
Westwood Tract:*						
Gross rentals	\$ 2,631.04				\$ 900.00	\$ 1,731.04
Expenses	4,027.07				1,201.82	2,825.25
Net rental income (loss)	\$ (1,396.03)				\$ (301.82)	\$ (1,094.21)
Bayshore Park Tract:*						
Gross rentals						
Expenses	43.28				\$ 10.82	\$ 32.46
Net rental income (loss)	\$ (43.28)				\$ (10.82)	\$ (32.46)
Morey Tract:						
Gross rentals	\$ 3,100.00				\$ 3,100.00	
Expenses	271.73				271.73	
Net rental income..	\$ 2,828.27				\$ 2,828.27	
Total—All Tracts:						
Gross rentals	\$468,606.07	\$ 83,480.81	\$135,563.37	\$169,676.57	\$ 77,476.51	\$ 2,408.81
Expenses	378,806.99	69,243.58	105,033.98	136,301.83	64,540.23	3,687.37
Net rental income..	\$ 89,799.08	\$ 14,237.23	\$ 30,529.39	\$ 33,374.74	\$ 12,936.28	\$ (1,278.56)

Note: Does not include any pro rata of Administrative expenses
totaling\$152,884.88 \$ 16,546.32 \$ 15,204.80 \$ 20,190.91 \$ 58,675.23 \$ 42,267.62

*Purchased from Western Homes, Inc.

EXHIBIT No. 3

Pacife Homes, Inc.

Profit from Real Property Sales
(Organization to liquidation of the company)

		June 1/42 to May 31/43	June 1/43 to May 31/44	June 1/44 to May 31/45	June 1/45 to May 31/46	June 1/46 to Apr. 30/47
	Total					
Homewood Tract:						
Sales proceeds	\$1,062,948.48	\$ 4,566.23	\$ 21,537.54	\$483,276.17	\$493,542.58	\$ 60,025.96
Costs and expense	794,888.76	3,324.39	17,365.54	410,449.63	332,442.20	31,307.00
Profit on sale	\$ 268,059.72	\$ 1,241.84	\$ 4,172.00	\$ 72,826.54	\$161,100.38	\$ 28,718.96
Southwood Tract:						
Sales proceeds	\$ 454,028.72			\$ 16,393.03	\$385,330.29	\$ 52,305.40
Costs and expense	349,374.48			14,038.27	296,676.05	38,660.16
Profit on sale	\$ 104,654.24			\$ 2,354.76	\$ 88,654.24	\$ 13,645.24
Shoreview Tract:						
Sales proceeds	\$ 389,056.89		\$ 38,146.09	\$ 5,447.48	\$338,613.32	\$ 6,850.00
Costs and expense	292,078.45		32,998.44	4,587.98	249,643.61	4,848.42
Profit on sale	\$ 96,978.44		\$ 5,147.65	\$ 859.50	\$ 88,969.71	\$ 2,001.58
Westwood Tract:						
Sales proceeds	\$ 103,989.66				\$ 10,711.07	\$ 93,278.59
Costs and expense	79,564.09				10,102.78	69,461.31
Profit on sale	\$ 24,425.57				\$ 608.29	\$ 23,817.28
Bayshore Park Tract:						
Sales proceeds	\$ 6,331.37					\$ 6,331.37
Costs and expense	3,855.74					3,855.74
Profit on sale	\$ 2,475.63					\$ 2,475.63
Morey Tract:						
Sales proceeds	\$ 243,949.65				\$237,354.96	\$ 6,594.69
Costs and expense	253,547.61				246,916.62	6,630.99
Profit on sale	\$ (9,597.96)				\$ (9,561.66)	\$ (36.30)
Total—All Tracts:						
Sales proceeds	\$2,260,304.77	\$ 4,566.23	\$ 59,683.63	\$505,116.68	\$1,465,552.22	\$225,386.01
Costs and expense	1,773,309.13	3,324.39	50,363.98	429,075.88	1,135,781.26	154,763.62
Profit on sale	\$ 486,995.64	\$ 1,241.84	\$ 9,319.65	\$ 76,040.80	\$ 329,770.96	\$ 70,622.39
Note: Does not include any pro rata of Administrative expenses						
totaling	\$ 152,884.88	\$ 16,546.32	\$ 15,204.80	\$ 20,190.91	\$ 58,675.23	\$ 42,267.62

EXHIBIT No. 4

Pacific Homes, Inc.

Investment in Real Property and
Notes and Mortgages Payable

	May 31/42	May 31/43	May 31/44	May 31/45	May 31/46	May 31/47
Investment in						
Improved Property:						
Cost	\$660,374.49	\$1,255,907.28	\$920,731.94	\$147,602.68		
Less allowance for depreciation	15,743.50	38,846.29	46,286.95	6,121.85		
Depreciated cost ..	\$644,630.99	\$1,217,060.99	\$874,444.99	\$141,480.83		
Construction in progress	\$159,468.98		122,528.13	81,428.45		
Materials for construction	65,890.37					
Subdivided lots					40,353.51	
	<u>\$225,359.35</u>	<u>\$644,630.99</u>	<u>\$1,217,060.99</u>	<u>\$996,973.12</u>	<u>\$263,262.79</u>	
Federal Housing Administration, 4½% Loan	<u>\$188,200.00</u>	<u>\$764,735.72</u>	<u>\$1,312,968.40</u>	<u>\$972,683.66</u>	<u>\$144,514.73</u>	

Note: At April 30, 1947, such houses as were not sold were assigned to and such loans as were not paid were assumed by Ross H. Chamberlain, Ltd:

Improved real estate	\$ 26,731.65
Federal Housing Administration loans	\$ 5,207.98

EXHIBIT No. 5

Pacife Homes, Inc.—Homewood Tract
Summary Showing Sales of Houses, All But One
of Which (Footnote c) Were Originally Occupied by Tenants
Under Leases With 30-Month Options to Purchase
(Homewood Tract)

Month and Year	Col. 1 Sales to Tenants Holding Purchase Options	Col. 2 Sales Made After Purchase Options Had Terminated and Tenants Had Been Occupied by New Tenant Under Simple Lease Option	Col. 3 Sales Made More Than 30 Months After Purchase Option Executed and Not Included in Column 1 or 2	Col. 4 All Sales	Col. 5 Number of Houses on Hand Part of Each Month	Col. 6 Number of Months From Date House Completed (Sept. 1, 42) to Date House Sold
1942						
June					50	
July					89	
August					156	
September					212	
October					212	
November					212	
December					212	
1943						
January					212	
February					212	
March					212	
April	1				212	7
May					211	
June	2				211	9
July					209	
August					209	
September					209	
October					209	
November	1				209	14
December				1 (a)	208	15
1944						
January				1 (a)	207	
February					206	16
March					206	
April					206	
May					206	
June	1				206	21
July	1				205	22
August	1				204	23
September	1				203	24
October	9				202	25
November	9				193	26
December	8				184	27
1945						
January	8				176	28
February	12				168	29
March	19				156	30
April	17	3			137	31
May	7	3		1 (b)	117	32
June	9			1 (a)	115	33
July	7			1 (a)	96	34
August	9	2		1 (c)	88	35
September	4		1		75	36
October	2	1			71	37
November	5	3	1		67	38
December	2	2			59	39
1946						
January	1	5	1	1 (a)	55	40
February	2	5	2		47	41
March	1	10	1	1 (a)	38	42
April	2	5			25	43
May		7	1		18	44
June		5		1 (b)	10	45
July					4	
August		4			4	47
September					0	
Totals	141	55	7	9		
				6 (a)		
				2 (b)		
				1 (c)		
				9		

(a) These houses were sold less than 30 months after the last purchase option agreement was executed.

(b) Unable to ascertain complete lease history. However, houses were completed and sold respectively June 1, 1942—May, 1945 and July, 1942—June, 1946, periods of 37 and 47 months. (Original purchase option lease agreements were dated August, 1942, and September, 1942, respectively.

(c) This house does not show evidence of a signed lease agreement. However, it was completed in August, 1942, and sold in August, 1945, a period of 36 months.

(Construction commenced approximately January, 1942.

(Construction completed approximately September, 1942.

EXHIBIT No. 6

Pacific Homes, Inc.—Southwood Tract

Summary Showing Sales of Houses at Southwood Tract—None
of Which Were Ever Occupied by Tenants Under Leases With
Options to Purchase

Month and Year	Sales to Non-tenants	Sales to Tenants	Number of Houses on Hand First of Each Month	Number of Months from Date House Completed (January 1, 1944) to Date House Sold
1944				
January			72	
February			72	
March			72	
April			72	
May			72	
June			72	
July			72	
August			72	
September			72	
October			72	
November			72	
December			72	
1945				
January			72	
February			72	
March			72	
April		2	72	15
May	5(a)	1	70	16
June		1	69	17
July	1		63	18
August	1		62	19
September	3		61	20
October	3		58	21
November	5	1(b)	55	22
December	1		49	23
1946				
January	2		48	24
February	3		46	25
March	7	7	43	26
April	7	3	29	27
May	12		19	28
June	4	3	7	29
July	1		0	30
Totals	55	18		
	==	==		

(a) One of these was sold to the manager of the tract who had been allowed to transfer his option from the Homewood tract.

(b) Sold twice.

Construction commenced approximately August, 1943.

Construction completed approximately January, 1944.

EXHIBIT No. 7

Pacific Homes, Inc.—Shoreview Tract
Summary Showing Sales of Houses at Shoreview Tract—None
of Which Were Ever Occupied by Tenants Under Leases With
Options to Purchase

Month and Year	Sales to Nontenants	Sales to Tenants	(a) Other	Number of Houses on Hand First of Each Month	Number of Months from Date House Completed (February 1, 1944) to Date House Sold
1943					
October			1		
November			4		
December			2		
1944					
January				53	
February				56	
March				56	
April				56	
May				56	
June				56	
July				56	
August				56	
September				56	
October				56	
November				56	
December				56	
1945					
January				56	
February				56	
March				56	
April	1			56	14
May				55	
June	2			55	16
July				53	
August	5			53	18
September	1	1		48	19
October	2			46	20
November	5			44	21
December	1	5		39	22
1946					
January	3	1		33	23
February	3	7		29	24
March	10	2		19	25
April	2			7	26
May	3	1		5	27
June	1			1	28
July				0	
Totals	38	18	7		
	==	==	==		

(a) This column represents sales where no written lease agreements were located in the file for each house.

Construction commenced approximately July, 1943.

Construction completed approximately February, 1944.

[Endorsed]: Filed December 13, 1954.



[Title of District Court and Cause.]

MEMORANDUM OPINION

This is an action to recover taxes which it is alleged were erroneously or illegally collected from plaintiff.

Roche, Chief Judge:

Ross Chamberlain and David O. Bohannon were the organizers and sole stockholders of Pacific Homes, Inc., Western Homes, Inc., Greenwood Corporation and Rollingwood Corporation. Each corporation followed a business pattern of renting defense housing to war workers (generally with an option to purchase) and then selling off the houses either to option holders or to others willing to buy.

Plaintiff's position is that the profits which resulted from their sales of defense housing were subject to the capital gains tax of 25% under Section 117 (j) of the U. S. Internal Revenue Code. Defendant claims that the profits from the sales of defense housing should be taxed at ordinary income and excess profits tax rates in the same manner as if the houses constituted property held by plaintiff primarily for sale to customers in the ordinary course of its trade of business.

This specific issue has been considered by our Ninth Circuit Court of Appeals in two cases, Rollingwood Corporation v. Commissioner of Int. Rev. (1951), 190 F. 2d 263; Lucille McGah v. Commissioner of Int. Rev. (1954), 210 F. 2d 769.

In the Rollingwood Case the Tax Court found that the corporation held its houses primarily for sale to customers in the ordinary course of its trade or business within the meaning of Section 117 (j); therefore, the profit from these sales was taxable as ordinary income and not as capital gain.

In *McGah v. Commissioner*, 210 F. 2d 769, a different situation existed than in the instant case. In that case it clearly appeared that the builder was forced to sell some of his houses in order to liquidate an excessive bank indebtedness. Further, even at the time of trial the taxpayer continued to be engaged in the rental business. The court expressed the view that petitioner constructed the houses primarily for investment purposes, and went on to state that it found no support for the conclusion that the taxpayers had changed their admitted purpose of holding their properties for rental.

Certainly, there may be a change of intent between the time of acquisition of property and the time of sale, i.e., the taxpayer may originally build houses for investment and then by frequent sales in later years demonstrate that renting had been forsaken and that the properties were then being held primarily for sale to customers. This occurred in the instant case, and is evidenced by both the expressed intent and the actual activities of the taxpayer. As early as December 9, 1943, before the corporation had made many sales, the intention to engage in the sale of houses was stated by the chairman of the Board of the corporation and an ap-

propriate resolution was adopted authorizing future sales and ratifying previous sales. The minutes of the special meeting of the Board of Directors of December 9, 1943, are persuasive evidence of the actual intention of the corporation to engage in the business of selling houses. Once this decision to sell was made Pacific Homes made frequent, continuous sales of the housing. As stated in the Rollingwood case such activity is ample to support a finding that the corporation was in the business of selling real property.

Out of the total of 347 houses built by Pacific Homes, Inc., 7 were immediately sold and 212 were immediately rented with options in the renters to buy. Such houses necessarily were held by the corporation from the very beginning for sale to the tenants, if the tenants decided to buy. The corporation voluntarily chose this method of doing business and they had no alternative but to sell when the options were exercised. It was therefore in the course of its ordinary business to sell to tenants who exercised their options to buy. The exhibits show that 141 options were exercised by tenants of Pacific Homes. It can be seen that renting the houses with options in the tenants to purchase was itself an effective sales device. In the period from June, 1942, to September, 1946, Pacific Homes sold every one of the 347 houses it had built.

The most that can be said in plaintiff's favor, considering all of the evidence, is that it intended to

pursue whichever activity, renting or selling, proved more profitable, i.e., if the rental market were good they would continue to rent, but if the sales market were high they would sell. Under the Rollingwood decision, such intention is sufficient to make the profit from sales taxable as ordinary income.

It is urged that the procedure followed by plaintiff in disposing of a rental operation certainly did not follow the pattern of advertising and other sales promotion techniques used by real estate firms holding real estate primarily for sale to customers in the ordinary course of their trade or business. However, Mr. Chamberlain readily explained that the reason for this was the fact that the houses sold themselves. Thus, it was not necessary for the corporation to engage in an extensive advertising or selling campaign. When one considers the volume of houses sold, there is no question of the truth of the statement that these houses "sold themselves." According to Mr. Chamberlain, even the decision not to put up "for sale" signs had a sales motive in that a commodity in apparently "scarce" supply is more attractive to a buyer.

Viewing the activities of plaintiff in light of the legislative purpose and policy this court concludes that the houses in question were held by Pacific Homes primarily for sale to its customers in the ordinary course of its trade or business, and that the gain from sales thereof should be taxed as ordinary income.

In accord with the above reasoning

It is Hereby Ordered that judgment be entered herein upon findings of fact and conclusions of law in favor of the defendant, United States of America, and that the respective parties pay their own costs.

Date: February 2, 1955.

/s/ MICHAEL J. ROCHE,
Chief Judge,
U. S. District Court.

[Endorsed]: Filed February 2, 1955.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS
OF LAW

The above-entitled case came on for trial on December 13, 1954, plaintiff being represented by L. W. Wrixon, Esq., and Carl R. Schulz, Esq., and defendant being represented by Lloyd H. Burke, Esq., United States Attorney, and George A. Blackstone, Esq., Assistant United States Attorney. A stipulation of facts was filed, oral and documentary evidence were introduced, and the case was argued orally and on briefs. The Court having filed its memorandum order for judgment for defendant on February 2, 1955, the Court now makes the following Findings of Fact and Conclusions of Law:

Findings of Fact

1. This action is brought pursuant to 28 U.S.C., Section 1346(a)(1) by plaintiff against defendant

United States of America for the refund of corporate excess profits taxes for the fiscal year ending May 31, 1945, in the alleged sum of \$18,741.37 plus interest; for the refund of corporate income taxes for the same fiscal year in the alleged sum of \$4,065.53 plus interest; for the refund of corporate excess profits taxes for the fiscal year ending May 31, 1946, in the alleged sum of \$111,151.11 plus interest; and for the refund of corporate income taxes for the fiscal year ending May 31, 1947, in the alleged sum of \$7,083.47 plus interest.

2. Plaintiff was incorporated under the laws of California on August 9, 1941, and was dissolved on May 31, 1947. Twenty-sixes shares of plaintiff's stock were originally issued to David D. Bohannon who sold such shares to plaintiff's treasury on May 10, 1945. Twenty-four shares of plaintiff's stock were originally issued to Ross H. Chamberlain who, after May 10, 1945, was the sole stockholder of plaintiff corporation.

3. Plaintiff was organized for the purpose of engaging in the business of developing real estate subdivisions and renting and selling houses primarily to defense workers. Plaintiff so described its business on its federal tax returns, and plaintiff did in fact engage in such business during the period here in issue.

4. On or about September 1, 1942, plaintiff completed the construction of 212 single-family dwelling houses in a subdivision known as "Homewood Tract." On or about January 1, 1944, plaintiff com-

pleted the construction of 72 single-family dwelling houses in a subdivision known as "Southwood Tract." On or about February 1, 1944, plaintiff completed the construction of 63 single-family dwelling houses in a subdivision known as "Shoreview Tract."

5. Seven of the houses in the Shoreview Tract were sold in the last three months of 1943 immediately upon construction. All 212 houses in the Homewood Tract were initially rented after construction to defense workers under leases containing options in the tenants to purchase the houses within 30 months. All of the houses in the Southwood Tract and the unsold houses in the Shoreview Tract were initially rented after construction without options in the lessees to buy the houses.

6. On December 9, 1943, the Board of Directors of plaintiff authorized the future sale of plaintiff's houses and ratified past sales. At that meeting the Chairman of the Board of Directors of plaintiff expressed the intention of plaintiff to sell its houses. Thereafter plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable.

7. Renting the Homewood Tract houses with purchase options in the tenants was an effective sales device in that it created a ready-made sales market for those houses. Such houses were necessarily held for sale to tenants if they decided to exercise their options. Plaintiff voluntarily and without any compulsion from Federal Governmental agencies or other third parties granted the options

to buy to the lessees of the Homewood Tract houses. Renting with option to buy was a method of doing business. In renting the Homewood Tract houses with options to buy, plaintiff was pursuing the same method of doing business as Western Homes, Inc., Rollingwood Corporation and Greenwood Corporation, which corporations were initially wholly owned and managed by the same two stockholders who initially owned and managed plaintiff corporation.

8. After several months of rental experience, plaintiff found it to be unprofitable to continue to rent any of its houses. Plaintiff thereupon decided to hold all of its houses in the Homewood, Southwood and Shoreview Tracts primarily for sale to customers in the ordinary course of business in addition to those houses in the Homewood Tract which were already held by plaintiff primarily for sale under outstanding lease-option agreements. The tract managers were then instructed by plaintiff to sell the houses as they became vacant. There was no economic pressure placed upon plaintiff by Federal Governmental agencies or other third parties to sell the houses. The decision to sell all of its houses was voluntarily made by plaintiff for the purpose of maximizing its profits in the ordinary course of its trade or business. The sales here in issue took place after the decision was made to hold the houses primarily for sale.

9. Commencing in June, 1944, and continuing through April, 1946, 137 houses in the Homewood

Tract were sold to tenants exercising options in their leases to purchase. Commencing in April, 1945, and continuing through August, 1946, the remaining 69 houses in the Homewood Tract were sold to persons without options to buy.

10. Commencing in April, 1945, and continuing through July, 1946, all 72 houses in the Southwood Tract were sold.

11. Commencing in April, 1945, and continuing through June, 1946, all remaining 56 houses in the Shoreview Tract were sold.

12. The sales of the houses in the Homewood, Southwood and Shoreview Tracts were frequent and continuous during the tax years in question, and all of the houses in those tracts had been sold by the end of August, 1946.

13. In addition to the sales of houses in Homewood, Southwood and Shoreview Tracts, plaintiff sold all of its houses in three other tracts, not here in issue, during the fiscal years ending May 31, 1946, and May 31, 1947, plaintiff having acquired such other tracts in its fiscal year ending May 31, 1946. Plaintiff went out of business and dissolved on May 31, 1947.

14. Because of the wartime and postwar demands for houses, plaintiff's houses were sold without the necessity of engaging in extensive advertising or sales campaigns. The houses in effect sold themselves. The absence of "For Sale" signs on the tracts had a sales motive and was a deliberate sales techni-

que of plaintiff to give prospective customers a sense of scarcity of available houses for sale and thereby make the house being sold seem more desirable. Most of the sales were made by plaintiff's salaried tract managers but where their efforts were not sufficient, sales were effected through real estate brokers on a commission basis. Plaintiff's selling activities under the circumstances, together with the frequency and continuity of sales, were sufficient to constitute a trade or business of selling houses.

15. The houses in the Homewood Tract which were sold to tenants pursuant to options to buy were held primarily for sale to customers in the ordinary course of plaintiff's trade or business from the time the lease-option agreements were executed.

16. The houses in the Homewood Tract which were sold to persons without options to buy and the houses in the Southwood and Shoreview Tracts here in issue were held primarily for sale to customers in the ordinary course of plaintiff's trade or business from the time when the decision was made, prior to the sales in question, to sell all houses as they became vacant including those not then subject to lease-option agreements.

Conclusions of Law

1. Income received by plaintiff from the sale of its houses during its fiscal years ending May 31, 1945; May 31, 1946, and May 31, 1947, was taxable as ordinary income and not as capital gain.

2. The Commissioner of Internal Revenue correctly and lawfully determined the tax liability of plaintiff for its fiscal years ending May 31, 1945; May 31, 1946, and May 31, 1947.

3. Defendant is entitled to judgment herein against plaintiff, dismissing its complaint and the claims therein stated with each party to pay its own costs.

Let judgment be entered accordingly.

Dated: February 16th, 1955.

/s/ MICHAEL J. ROCHE,
United States District Judge.

Affidavit of Mail attached.

Lodged February 9, 1955.

[Endorsed]: Filed February 16, 1955.

In the United States District Court for the Northern
District of California, Southern Division
Civil No. 31368

PACIFIC HOMES, INC., a California Corporation,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT

This cause came on regularly to be heard without a jury before the above-entitled Court, the Honor-

able Michael J. Roche presiding, on December 13, 1954. Plaintiff appeared by L. W. Wrixon, Esq., and Carl R. Schulz, Esq. Defendant appeared by Lloyd H. Burke, Esq., United States Attorney, and George A. Blackstone, Esq., Assistant United States Attorney. The stipulation of facts was filed, oral and documentary evidence were introduced, and the Court having made its findings of fact and conclusions of law,

Now Therefore, by reason of the law and the evidence and the findings of fact and conclusions of law aforesaid,

It is Hereby Ordered, Adjudged and Decreed that plaintiff take nothing by its action and that its complaint and the claims therein stated be and the same are dismissed without costs.

Dated: February 16, 1955.

/s/ MICHAEL J. ROCHE,
Judge, United States District
Court.

Lodged February 9, 1955.

[Endorsed]: Filed February 16, 1955.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is Hereby Given that Pacific Homes, Inc., a California corporation, plaintiff above named,

hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on February 17, 1955.

Dated: March 10th, 1955.

/s/ L. W. WRIXON,

/s/ CARL R. SCHULZ,

Attorneys for Plaintiff.

Receipt of Copy acknowledged.

[Endorsed]: Filed March 10, 1955.

—————

The United States District Court, Southern District
of California, Southern Division
No. 31368

PACIFIC HOMES, INC., a California Corporation,
Plaintiff,

Plaintiff,

vs.

THE UNITED STATES OF AMERICA,

Defendant.

Before: Hon. Michael J. Roche, Judge.

REPORTER'S TRANSCRIPT ON APPEAL
PROCEEDINGS ON TRIAL

Appearances:

For Plaintiff:

L. W. WRIXON, ESQ., and
CARL R. SCHULZ, ESQ.

For the Government:

LLOYD H. BURKE, ESQ.,

United States Attorney, By

GEORGE BLACKSTONE, ESQ.,

Assistant U. S. Attorney.

* * *

OPENING STATEMENT ON BEHALF OF THE PLAINTIFF

Mr. Wrixon: If it may please your Honor, there are two cases which are before the Court. One is *Pacific Homes, Inc., vs. United States*, and the other is *Western Homes, Inc., vs. United States*. Both of the cases involve the same principle.

With your Honor's permission, I would prefer to refer first to the *Pacific Homes, Inc.*, and then to the *Western Homes, Inc.*

The case of *Pacific Homes, Inc.*, is a suit by the plaintiff, a California corporation, to recover certain Federal income and Federal excess profits taxes which the plaintiff contends were erroneously and illegally collected [3*] by the defendant for the plaintiff's fiscal years ended May 31st, 1945, May 31st, 1946, and May 31st, 1947. The corporation was organized prior to those years, but during the years 1943 and 1944, although it was an operating organization, there did not result in its operations any problem concerning taxes which is now before the Court.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

During the years 1943 and 1944 the plaintiff caused houses to be constructed for rental to war workers. The plaintiff leased these houses to war workers and ultimately sold the houses in these various tracts. Much of the story, factually, is told by the stipulation which has been entered into by the parties and certain exhibits which are attached to the stipulation.

With your Honor's permission I propose to read into the record the stipulation of facts which has been entered into and at this time will not include in my opening remarks a number of factual matters which might otherwise be included in an opening statement.

Witnesses will be available to explain the exhibits which are attached to the stipulation, and to explain the circumstances under which the houses were constructed by the plaintiff and rented and ultimately sold.

In general, between the date of the incorporation of the plaintiff and the date of its final liquidation, the plaintiff collected an aggregate of approximately \$469,000 in rents, [4] against which it paid some \$379,000 in expenses—direct expenses, that is—leaving a net rental income of approximately \$90,000. Statements are attached to the stipulation showing in detail the amount of those rents, segregated as between the various tracts, and the amount of the expenses, allocated likewise to the various tracts.

Statements are also being presented showing by months the sales of houses that were made by the plaintiff from three of its tracts. These three tracts

are the Homewood Tract, which was completed approximately September 1st, 1942, and involved 212 houses; the Southwood Tract, which was completed approximately January 1st, 1944, involving 72 houses; and the Shoreview Tract, which was completed approximately February 1st, 1944, involving 63 houses.

During the Fiscal Years ended May 31st, 1945, May 31st, 1946, and May 31st, 1947, the plaintiff sold some of these houses from the three tracts to which I have just made reference. These sales during these three fiscal years represented the sales of houses which had been held for more than six months at the time of sale. The plaintiff represented the profit on these sales on its Federal income and excess profits tax returns as long-term capital gains. The defendant has assessed and collected taxes on the ordinary income and excess profits tax returns on the gains from the sales of these houses. [5]

In addition to the sales of the houses out of the Homewood, the Southwood and Shoreview Tracts, which were held over six months, the plaintiff sold certain other property, the proceeds of which, however, are not involved in this case taxwise because the properties other than the Homewood, Southwood and Shoreview properties were properties which had not been held for six months at the time of sale. This latter type of sale was represented either as ordinary income or as short-term capital gains, and accordingly these sales are not involved in this proceeding.

The sole issue in the case, as the plaintiff sees it, is how the net gains from the sales in Homewood,

the Southwood and the Shoreview tracts should be taxed; that is, whether the plaintiff should be taxed on these sales as long-term capital gains and as a limited rate of tax applicable to those properties, or whether, as the Government contends, the gains from the sales of these houses should be treated as just like any other ordinary income, and should be taxed in ordinary returns and excess profits returns, which are greatly in excess of the capital gains return.

The statute which is involved in this case is Section 117(J) of the United States Internal Revenue Code—that is, the 1939 Code and not the 1954 Code. With your Honor's permission, I should like to make a short reference to the Section. The Section is in three parts and I will read from [6] Section 2. First, it states the general rule:

“If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than six months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital

assets held for more than six months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.”

Now, Section 1 defines the term “Property Used in the Trade or Business.” Section 1 reads in part:

“For the purposes of this sub-section, the term ‘Property Used in the Trade or Business’ means property used in the trade or business of a [7] character which is subject to the allowance for depreciation provided in Section 23(1) held for more than six months, and real property used in the trade or business, held for more than six months, which is not (A) property of a kind which would properly be includable in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical or artistic composition, or similar property, held by a taxpayer described in Sub-section (a)(1)(C).”

The issue, then, before the Court is whether the real property which was sold by this plaintiff during the three taxable years just mentioned constitutes property which may be classified under Section 117(J) as property entitled to the capital gain treatment or whether the property is of the type that is referred to in the section as being owned primarily for sale to customers in the ordinary course of its trade or business.

A memorandum has been prepared for submission to your Honor which lists a number of the cases which have caused this issue. Your Honor may be familiar with those cases in our Ninth Circuit which have considered this question. One is [8] the *Rollingwood* case—*Rollingwood Corporation versus Commissioner of Internal Revenue*, 190 Fed. 2d 263, decided on June 21st, 1951.

And another case, also in our Ninth Circuit, is *Lucille McGah vs. Commissioner of Internal Revenue*, 193 Fed. 2d, 662, decided January 4th, 1952; and a second appeal in the very same case decided by our Ninth Circuit on February 18, 1954, at 200 Fed. 2d, 769.

There are decisions on this issue in other jurisdictions. We have prepared a memorandum for submission to your Honor which includes as an exhibit a reprint of an article on this subject which refers to and analyzes a number of cases, some of which are in favor of the Government, some of which are in favor of the taxpayer. The article also outlines certain factors which the courts have taken into consideration in determining whether in this type of case the property was entitled capital gains treatment or should be regarded as property owned primarily for sale in the course of the trade or business.

The Court: Did you serve a copy on your opponent?

Mr. Wrixon: Yes, your Honor.

* * *

OPENING STATEMENT ON BEHALF OF
THE GOVERNMENT

Mr. Blackstone: May it please the Court, I intend to be very brief:

Both of these causes involve a very simple question of [9] fact for your Honor to decide. In each case the question is, did the taxpayer hold these houses for sale primarily to customers in the regular course of its trade or business?

We are maintaining that these two cases, *Pacific Homes, Inc., vs. United States*, and *Western Homes Corporation vs. United States*, are to all intents and purposes identical with the decision cited by Mr. Wrixon, *Rollingwood Corporation vs. Commissioner of Internal Revenue*. The parties involved, the stockholders, are the same; the whole scheme of both corporations involved in this litigation and *Rollingwood* are the same.

There is no substantial distinction of fact in these cases and the *Rollingwood* case, and I think your Honor, after you have read the *Rollingwood* case and compared it with the facts in this case, will be convinced the decision in the *Rollingwood* case is correct and is binding for all purposes in this litigation.

In the *Rollingwood* case the taxpayer corporation contested a deficiency assessment in the first instance, and went to the tax court for redetermination, and the tax court decided that the corporation held the houses primarily for sale to customers in the regular course of the trade or business; and

on appeal the Ninth Circuit Court affirmed that decision.

In these cases the two taxpayers elected to pay the deficiency assessment and are now suing in Federal Court for [10] refund.

I think it is important to bring to your Honor's attention at the outset the very important part of the decision of the Ninth Circuit in that Rollingwood case.

They stated there, Judge Bone writing the decision, that the word "primary"—"owned property primarily for sale"—"primarily" does not mean the only purpose of the business, or the first purpose or principal business. Judge Bone said those words in Section 117(J) of the Internal Revenue Code simply mean "substantial" or "essential." If one of their essential, fundamental, substantial purposes was to sell the houses they had constructed, then the profit from the sale of those houses should be taxed as ordinary income and not as capital gain.

The Court: Call your first witness.

Mr. Wrixon: If your Honor please, I would like at this time to offer the stipulation which has been entered into between the parties.

The Court: Read it into the record.

Mr. Wrixon: With your Honor's permission, might I read into the record the stipulation which has just been filed as a continuing memorandum of factual matters which I intentionally omitted in my opening statement, but which I think might well be before the Court at this time?

The Court: Embodied in this stipulation? [11]

Mr. Wrixon: Yes, your Honor.

The Court: Very well, proceed.

(Thereupon, Stipulation dated December 13, 1954, was read to the Court.)

Mr. Wrixon: If your Honor please, I appreciate that this is not the time to argue the case, but I can't help making a reference to the case of **Rollingwood** to which counsel referred in his opening statement.

When your Honor reads the case you will see that the Court very definitely points to the fact that 28 sales of houses were made in the first fiscal year and 178 sales in the second fiscal year of **Rollingwood's** existence to persons who did not have rental-option agreements, and that was stated to be a very important fact and very persuasive with respect to the——

Mr. Blackstone: I object to his arguing now the merits of the case. If he wants to present them at the proper time, it is perfectly all right. [12]

* * *

JAMES E. MOORE

was called as a witness on behalf of the plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

* * *

Direct Examination

By Mr. Wrixon:

Q. Mr. Moore, did you prepare any exhibits in connection with the rental and the leasing of houses

(Testimony of James E. Moore.)

by Pacific Homes, Inc.? A. Yes.

Q. And will you state to the Court from what records of the plaintiff you prepared such data?

A. Well, I prepared it from the Sales Journal of the Corporation, and from various file folders which were kept for [13] each house, containing various information.

Mr. Wrixon: Counsel, I show you this folder (handing document to Mr. Blackstone).

Q. (By Mr. Wrixon): I will show you what purports to be a folder containing certain data, and will you state to the Court whether you have ever seen the folder and what the folder consists of?

A. Well, I have seen this folder and it consists of an application form for rental, and a lease agreement form, and other papers pertinent to the sale of the house.

Q. Does it state that the corporation maintained similar folders for other houses in the Southwood Tract? A. Yes.

Q. And is the folder which you have in your hand one of the folders which you examined in connection with the data which you have prepared for the Southwood Tract? A. Yes.

Mr. Wrixon: If your Honor please, I will offer in evidence as Plaintiff's exhibit next in order, a file folder relating to the Southwood Tract houses.

The Court: It may be admitted and marked.

Mr. Blackstone: Could that be numbered as the next one after the exhibits attached to the stipulation so that we won't get confused? I think there

(Testimony of James E. Moore.)

are seven exhibits attached to the stipulation which have already been numbered Exhibits [14] one through seven. If this could be Exhibit 8 and then followed from there on, it would be easier to keep them straight, I think.

Mr. Wrixon: That is satisfactory with the plaintiff.

The Court: Satisfactory to the clerk?

(Whereupon file folder referred to above was received in evidence and marked Plaintiff's Exhibit No. 8.)

PLAINTIFF'S EXHIBIT No. 8

[Plaintiff's Exhibit No. 8 is a folder containing the papers relating to the sale of a house in the Southwood Tract.]

Pacific Homes, Inc.

March 16th, '44.

Mr. and Mrs. Chet Harshman,
University Ave.,
Los Altos, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$75.00 for the first and 12th months' rent of the dwelling located at No. 481 Southwood Ave., Sunny-

(Testimony of James E. Moore.)

vale, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$50.00 per month payable in advance on the first day of each calendar month.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ G. M. BERGER.

Received and agreed to:

/s/ ARTHUR E. HARSHMAN.

Date.....

Rate.....

Deposit or Rent Is Not Refundable

Posted, DW.

Received March 17, 1954.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, I will show you the stipulation which has been received by the Court, and particularly Exhibit No. 6 attached to the stipulation relating to the Southwood Tract, and I will ask you, did you prepare Exhibit 6?

(Testimony of James E. Moore.)

A. Yes.

Q. Will you state to the Court from what data you prepared Exhibit 6?

A. Well, it was from the file folders and the sales journal previously mentioned.

Q. Well, will you explain to the Court the data which you have shown on Exhibit 6, please?

A. Well, it shows the sales by month and year of 72 houses in the Southwood Tract. None of these houses were ever occupied by tenants who had leases with options to purchase. One of these houses was sold to the Manager of the tract, who had been allowed to transfer his option from the [15] Homewood Tract.

It also shows the number of houses owned at the first of each month. And in the last column it shows the period each house was held from the date of completion to date of sale.

In reference to that column you will see that fifteen houses—correction on that. You will see that seventy-two houses were held for fifteen months until sold.

In some instances that period might be longer than fifteen months because in preparing this schedule I have taken the completion date as the date at which the entire tract was completed, and also I have excluded the month of sale.

Q. May I interrupt you? Some of the houses might have been completed prior to the completion date set forth on the exhibit, is that right?

A. Yes.

(Testimony of James E. Moore.)

Mr. Blackstone: Just a minute. I object to his testifying what might have been. It seems to me he should state what appears in the folder, and I don't think it would be of any help for him to testify to speculative matters. If there is evidence on those facts, it can be produced by witnesses who know the facts.

Mr. Wrixon: Well, just explain to the Court the use of the date January 1, 1944, on the exhibit.

The Witness: That was the date the entire tract was [16] completed.

However, in examining these file folders, I would say that there was somewhere leases were executed prior to that date—I mean that the houses were completed prior to that date.

The Court: Does time enter into the merits of this matter?

Mr. Blackstone: Not so far as I am concerned; but it was just a matter of his testimony as to what might have been, and I didn't know what he was basing that on.

The Court: All right, proceed. The ultimate fact is that 72 houses were all sold on what date?

The Witness: Well, they were sold at various dates.

The Court: Final date, I mean?

The Witness: Finally they were sold in July of 1946, the last sales took place.

The Court: I see.

Q. (By Mr. Wrixon): Mr. Moore, I show you what purports to be another folder containing the

(Testimony of James E. Moore.)

same data, and I will ask you have you ever seen the folder and, if so, state to the Court what it includes.

A. Well, I have seen this folder and it pertains to the Shoreview Tract and contains a lease agreement form and other papers which are pertinent to the sale.

Q. Did you use the data in this folder in compiling any of [17] the statistical data concerning the Shoreview Tract? A. Yes.

Q. And did you examine other folders for each of the houses in the Shoreview Tract containing similar data? A. Yes.

Mr. Wrixon: I will offer in evidence as Plaintiff's exhibit next in order the folder relating to the Shoreview Tract.

The Court: It may be admitted and take the next number.

(Whereupon folder relating to Shoreview Tract was received into evidence and marked Plaintiff's Exhibit No. 9.)

(Testimony of James E. Moore.)

PLAINTIFF'S EXHIBIT No. 9

[Plaintiff's Exhibit No. 9 is a folder containing the papers relating to the sale of a house in the Shoreview Tract.]

Job #35.

Lot #93.

Pacific Homes, Inc.
Shoreview Tract
San Mateo, Calif.

Date: Dec. 23, 1943.

Mr. and Mrs. Irving W. North,
441 Merritt Ave.,
Oakland, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$63.36 for the first and 12th months' rent of the dwelling located at No. 1311 - 2nd Ave., San Mateo, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$50.00 per month payable in advance on the 1st day of each calendar month, at the San Francisco Bank, Burlingame Branch.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ DORIS H. PINGREY.

(Testimony of James E. Moore.)

1st Mo., 13.36

12th Mo., 50.00

63.36

Received and agreed to:

/s/ IRVING W. NORTH,

/s/ MRS. GRACE NORTH.

Date.....

Rate.....

Deposit or Rent Is Not Refundable

Received January 10, 1944.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, I will show you Exhibit 7 attached to the stipulation and ask you, did you prepare Exhibit 7? A. Yes.

Q. And did you prepare Exhibit 7 from—partially from the data contained in the folder, one of which has just been admitted into evidence?

A. Yes.

Q. Did you examine all the folders in the Shoreview Tract in order to prepare Exhibit 7, attached to the stipulation? A. Yes.

Q. Will you explain the data contained in Exhibit 7 to the Court, please? [18]

A. Well, it shows the sales by month and year of these 63 houses in the Shoreview Tract. None of

(Testimony of James E. Moore.)

these houses were ever occupied by tenants who had leases with option to purchase.

It also shows that in the column headed "Other" with an (a) there were seven houses sold immediately or shortly after completion.

Q. Does the statement show when the next sale was made, Mr. Moore?

A. Yes. The next sale was made in April of 1945.

Q. Does the statement also show when the last house in that tract was sold?

A. Yes. That was June of 1946. The exhibit also shows the number of houses held the first of each month, and in the last column it shows the number of months the house was held from completion date until sold. That completion date is the date the entire tract was completed. And as I had mentioned previously, the period held could be longer than as shown in that column because of the fact that—

Mr. Blackstone: I object to that form of testimony and ask it be stricken. He should testify what exists in the folder relating to those exhibits.

Q. (By Mr. Wrixon): Do you see in the folder any leases indicating a date prior to the date of completion used in preparing the exhibit? [19]

A. Yes. Also in computing this period I did not include the month of sale.

Q. Mr. Moore, I will show you what purports to be a folder containing certain data and ask you to state to the Court whether you have ever seen that folder and, if so, what it contains?

A. Well, I have seen this folder before, and it

(Testimony of James E. Moore.)

contains information relating to a house in the Homewood Tract. There is a form of application for rental, and a lease agreement form, and other information relating to the sale of the house.

Q. Did you examine a similar folder for other houses in the Homewood Tract? A. Yes.

Q. And did you use the data contained in those folders in part in preparing an exhibit with respect to the Homewood Tract? A. Yes.

Mr. Wrixon: And, if your Honor please, I will offer in evidence as Plaintiff's exhibit next in order a folder relating to the Homewood Tract.

The Court: These various folders, who had them? Who was responsible for them?

Mr. Wrixon: Will you state to the Court whether those folders were the folders of the plaintiff, Pacific Homes? .

A. Yes, they were. [20]

Mr. Wrixon: Is there any other question, your Honor?

The Court: Where did you get them?

The Witness: Well, they were being kept in the garage of Mr. Chamberlain.

The Court: This is a resume or digest of the business done by these various corporations?

The Witness: Yes. Relating to these houses.

The Court: All right, let it be admitted and marked.

(Thereupon folder relating to Homewood Tract was received in evidence and marked Plaintiff's Exhibit No. 10.)

(Testimony of James E. Moore.)

PLAINTIFF'S EXHIBIT No. 10

[Plaintiff's Exhibit No. 10 is a folder containing the papers relating to the sale of a house in the Homewood Tract.]

Pacific Homes, Inc.

Homewood

Date: Feb. 6, 1944.

Mr. and Mrs. Lester I. Parker,
Glenallen, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$81.00 for the first and 12th months' rent of the dwelling located at No. 338 Orchard Ave., Sunnyvale, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$45.00 per month payable in advance on the 1st day of each calendar month.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ P. C. MARSHALL, by L.L.

(Testimony of James E. Moore.)

Received and agreed to:

/s/ LESTER I. PARKER,

/s/ MILLICENT PARKER.

Date: 2/6/44.

Rate.....

Block 6.

Job 204.

Lot 24.

Deposit or Rent Is Not Refundable

Posted: M. Pascal.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): These folders to which you have just made reference, were they used by you in preparing Exhibit 5 attached to the stipulation, referring the Homewood Tract, Mr. Moore?

A. Yes.

Q. Will you state to the Court the meaning of the data contained in Exhibit 5 attached to the stipulation?

A. Well, it is an exhibit showing the sales by month and year of the 212 houses in the Homewood Tract.

The Court: Dates?

The Witness: The date, your Honor?

(Testimony of James E. Moore.)

The Court: Yes.

The Witness: Well, the last sale took place August of 1946. The first sale took place April of 1943. All but one [21] of these houses was originally occupied by tenants who had leases with 30-month options to purchase. Column 1 shows the sales to these tenants who had options to purchase and who exercised them.

Columns 2, 3 and 4 show sales to persons who did not have options to purchase.

Column 2 shows instances where after the original—or qualifying it, where the option had terminated, the house was then rented to a tenant without a purchase option.

Q. (By Mr. Wrixon): What was the date of the first sale of that type of case, Mr. Moore?

A. That was April of 1945. I may want to correct that. The first sale was in December of 1943, and then there was another sale in January, 1944, and then the sale took place as previously mentioned, April of 1945.

Now, in Column 3 are sales which were made more than 30 months after the last purchase option agreement had been executed.

And in Column 4 are various sales which were broken down as to six which had been sold less than 30 months after the last purchase option agreement was executed. There are two where I was unable to determine a complete leasing history. However, these two homes were held for periods of 37 and 47 months, respectively. Then there was one house

(Testimony of James E. Moore.)

which did not show evidence of a signed lease agreement. However, it was [22] held for 36 months.

Q. That data is shown in what column?

A. In Column 4, which shows a total of 9 houses. Column 5 shows the number of houses held the first of each month. And in Column 6 I have shown the number of months the house was held from date of completion of the entire tract to the date the house was sold.

Q. Now, Mr. Moore, did you make any tabulation of the leases shown in the Homewood, the Southwood and Shoreview Tracts to indicate the number of leases that were executed and the terms for which the leases were executed? A. Yes.

Q. I will show you what purports to be a statement entitled "Data re: Number and Types of Leases," and will ask you to examine the statement and state to the Court whether you prepared it?

A. Yes, I prepared this.

Q. From what material did you prepare it?

A. From the file folders that I examined.

Q. And the file folders contained leases which purported to be signed by tenants, is that correct?

A. Yes.

The Court: From one of these three folders?

The Witness: Well, from these and the other folders.

The Court: What other folders? [23]

The Witness: Well, there was a file folder for each house in each tract and those are the folders referred to.

(Testimony of James E. Moore.)

The Court: All right.

Mr. Wrixon: I will offer in evidence, if your Honor please, as Plaintiff's exhibit next in order a statement entitled "Data re: Number and Types of Leases."

The Court: It may be admitted and marked.

(Whereupon document above referred to was received in evidence and marked Plaintiff's Exhibit No. 11.)

PLAINTIFF'S EXHIBIT No. 11

Pacific Homes

Data Re Number and Types of Leases

	Total Leases Given	30 Month Option Leases	Non-Option Leases		
			Total	Month to Month	12 Months
Homewood tract.....	419	356	63	5	58
Southwood	89	None	89	None	89
Shoreview	63	None	63	None	63

At the Homewood tract the last option lease given was dated December 10, 1943, the first non-option lease was dated December 21, 1943.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, will you explain to the Court the data which you have compiled on Plaintiff's Exhibit 11?

A. It shows a breakdown of the three tracts of Pacific Homes, showing the total leases given for each tract; and of that total how many were 30-

(Testimony of James E. Moore.)

month option leases, the total which were non-option leases, and a breakdown of the non-option leases as to their duration. And it also states that the last option lease given in the Homewood Tract was dated December 10, 1943, and the first non-option lease was dated December 21st, 1943.

Q. What does the exhibit state as to the length of the leases which were granted to non-option tenants?

A. Well, it shows that in the Homewood Tract there were five given for five months—or for a month-to-month period, that [24] is—and 58 were given for 12-month periods. And in Southwood all 89 were given for 12-month periods. And the Shoreview all, or 63, were given for 12-month periods.

Q. Mr. Moore, referring to Plaintiff's Exhibit 10, will you examine Plaintiff's Exhibit 10 and state to the Court how many leases you found on the house represented by that folder? Will you give the dates of the leases, please, too?

A. All right. Well, there are four leases. There is one dated October 1, 1942; another dated June 15, 1943; another dated February 6, 1944; and a fourth one dated August 1, 1944.

Q. Will you also state to the Court which of those leases, if any, contain an option in the tenant to purchase?

A. The first two leases contain an option to purchase.

The Court: We will take a recess.

(Whereupon a short recess was taken.) [25]

(Testimony of James E. Moore.)

Q. (By Mr. Wrixon): Mr. Moore, I will show you the exhibits attached to the stipulations numbered 5, 6 and 7; and I also show you Plaintiff's Exhibit 11 relating to number and types of leases.

Will you state to the Court from the exhibits which I hand you for each of the tracts, the Homewood, Southwood and Shoreview; the number of houses in each tract or number of leases in each tract that were executed, please?

A. In the Homewood Tract there were 212 houses and there were 419 leases given. In the Southwood Tract there were 72 homes and 89 leases given. In the Shoreview Tract there were 63 houses and 63 leases given.

Q. Well, will you explain to the Court the reason the number of leases exceeded the number of houses?

A. Well, the reason for that was that some of the houses were rented more than one time.

Q. Can you tell from your examination of the records of the leases, Mr. Moore, in which tracts there were leases with option in the tenants to purchase and in which tract or tracts there were executed leases without option in the tenant to purchase?

Mr. Blackstone: That has already been stipulated to. I think it just prolongs this. Your stipulation indicated the Homewood Tract had leases with option and the other two tracts did not. [26]

Mr. Wrixon: Except that I wish to bring out, your Honor, that in the Homewood Tract they had

(Testimony of James E. Moore.)

leases of both types, too. I will ask the question directly.

Q. (By Mr. Wrixon): In the Homewood Tract, in your examination of the leases with reference to the homes in that tract, did you find both types of leases?

Mr. Blackstone: Just a minute. I think that is going to be contrary to the stipulation unless you fix it as to time. As I understand the stipulation, the houses originally were all leased with option.

Mr. Wrixon: That is right.

Mr. Blackstone: And it appears also from the stipulation that after some of the leases with option expired you entered into another type of lease. I don't know what more this witness can say than what we have stipulated.

The Court: I think that covers it.

Mr. Wrixon: Very well. No further questions.

Cross-Examination

By Mr. Blackstone:

Q. Mr. Moore, turning first to Exhibit 6, which was prepared by you for the Southwood Tract, as I recall you testified that that information was prepared from information appearing in certain folders; is that correct? A. Yes.

Q. And that was introduced into evidence as Exhibit 8, a [27] folder which is a sample folder for that tract. Was that your testimony?

A. Yes, if that is the folder.

(Testimony of James E. Moore.)

Q. Would you look at that folder and tell the Court whether that shows if the sale was made to a tenant or to a non-tenant?

A. It is taking some time. I know the last tenant was a fellow by the name of Pearson. I am trying to determine the purchaser here.

No, the sale was made to a non-tenant.

Q. Does that folder show whether a commission was obtained upon the sale of this house to a non-tenant? A. Yes, it does.

Q. How much was the commission?

A. \$342.50.

Q. Do you recall from looking at the other folders relating to Southwood Tract if a commission was collected upon the sale of a house to a non-tenant?

A. I couldn't recall that it was in every instance. I do recall that there were some sold where a commission was given, but I could not be specific.

Q. Does the folder indicate who the broker was who handled the transaction?

A. Yes. It indicates a Mr. F. F. Brackett.

Q. Does it say what company he is with or where he is [28] located?

A. No, it doesn't seem to.

Q. In regard to the folders that you looked at where a sale was made to a tenant, was there any commission exacted, if you recall from the folder?

A. No. What I would be saying would be speculation.

Q. Well, if you don't remember, Mr. Moore, that

(Testimony of James E. Moore.)

is a satisfactory answer. I just want to know whether you remember in the folders on sales made to tenants whether a commission was charged on the sale?

A. No, I don't remember. However, it doesn't seem likely.

Q. I am just interested in your memory as to what you saw in the folder.

Turning to Exhibit 9, which I believe was a sample folder from which you compiled the statistics shown on Exhibit 7 for the Shoreview Tract, does that show whether the sale was made to a tenant or a non-tenant?

A. That sale was made to a tenant.

Q. To a tenant? In regard to these statistics shown on Exhibit 7 for the Shoreview Tract, you have indicated that seven houses were sold in the last three months of 1943. Would the folders on those houses indicate whether the houses had been rented prior to sale or not?

A. No, they did not indicate that.

Q. Were any leases included in those folders for the sales [29] of the first seven houses?

A. No.

Q. There were no lease forms at all, is that correct? A. Correct.

Q. You do not know of your own knowledge, however, apart from the folders, if they were sold to tenants or non-tenants? A. That's right.

Q. Referring now to Exhibit 10, which is one of the folders from which you compiled statistics

(Testimony of James E. Moore.)

for the Homewood Tract, Exhibit 5, does that exhibit show whether the sale there involved was made to a tenant or a non-tenant?

A. It shows a sale to a non-tenant.

Q. Does it indicate whether the house was vacant prior to the sale?

A. No, it is practically impossible to tell that from the file folder.

Q. Turning to Exhibit 5, which is the Homewood Tract, do you have a copy of that?

A. No, I don't.

Q. Column 1, you testified, were sales to tenants holding purchase options. I am not clear in my mind. Mr. Moore, in regard to the other sales shown in Columns 2, 3 and 4. Were those sales made to tenants or to non-tenants?

A. They could have been either. They could have been a sale to a tenant without an option or to a non-tenant. [30]

Q. But the exhibit as it is prepared does not indicate one way or the other whether the sale was made to a tenant or to a non-tenant, is that correct?

A. That is correct.

Q. In Column 3, it isn't clear to me, what the necessity for such a column is here in this breakdown. You have, "Sales made more than 30 months after last purchase option agreement executed, and not included in Columns 1 or 2."

A. Yes. Well, Column 2 made the point that the sales were made—the sales were made after the purchase option had terminated, then the new tenant had come in under a non-option lease.

(Testimony of James E. Moore.)

Column 3 makes the point that these sales were made more than 30 months after the option agreement had been signed, but indicates that the option had terminated or expired due to the running of time, and then the sale had been made—to whom, I really don't know.

Q. In other words, the Column 3 you put, it might have been made to a tenant holding a simple lease without an option, might have been made to a person who wasn't a tenant at all, might have been made to a person who held the original lease with option, but who was holding over after the option expired, and the folders do not indicate which?

A. Yes, after the option expired, we don't know whether the option holder stayed there or not. [31]

Q. That could be determined, couldn't it, from looking at the name of the purchaser from the file and comparing with the name of the prior lessee?

A. Yes. However, these seven sales in Column 3 were not made to the option holders.

Q. I understand. The option was expired. But it could be determined whether or not a sale was made to a person who had previously been a tenant?

A. Yes. However, if that were the case, it would be in Column 1.

Q. I thought Column 1 was all those holding an option which had not expired?

A. Well, that is true. And it was sales to tenants who held an option to purchase. [32]

CHARLES P. MABEY

was called as a witness on behalf of the Plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

The Court: Your name, please?

The Witness: Charles P. Mabey.

The Court: Where do you live?

The Witness: San Carlos, California.

The Court: Your business or occupation?

The Witness: Public accountant.

The Court: How long have you been so engaged?

The Witness: Eighteen years.

The Court: Take the witness.

Direct Examination

By Mr. Wrixon:

Q. By whom are you employed, Mr. Mabey?

A. Lester, Herrick & Herrick, Certified Public Accountants.

Q. Have you been employed on the staff of Lester, Herrick & Herrick continuously since you joined them?

A. Yes, sir. 1936.

Q. What has been the nature of your work, Mr. Mabey?

A. Well, I started with them as a Junior Accountant and I have been employed continuously. I now am engaged in auditing, preparation of tax returns, consultation, and so forth. [37]

Q. Have you had anything to do with the accounts of Pacific Homes, Inc.?

A. Yes, sir.

(Testimony of Charles P. Mabey.)

Q. What was the nature of the first work done by you for Pacific Homes, Inc.?

A. Pacific Homes, Inc., contacted us in 1942, and when I was assigned to the case it was with the purpose of reviewing their accounts to see if they were adequate.

Q. Did you make any suggestion as to the records to be kept by them?

A. Well, at that time the construction of the subdivision known as Homewood had been completed, and I found that the accounting in that connection was all right, but that there were certain matters of importance that needed attention.

Since the houses had been completed and rented—that is, partially, or not completely rented—I do not recall, but the matter of year's depreciation was important, which I did. There was the matter of rentals coming in and some kind of control was required there.

Then, payments were being made to the bank on FHA. Some type of control was needed there, and particularly as it relates to the reserve fund portion of the FHA payment. I guess that was the urgent items at that time.

Q. Did you suggest the installation of any particular records by Pacific Homes? [38]

A. The extent of their accounting actually I do not recall, particularly as to what they had already done beyond that of the construction; but we did give attention to the thing that was important,

(Testimony of Charles P. Mabey.)

which was operation accounts of the subdivision, and I provided them with a rent record which combined also the features of payments made on FHA to the bank, showing how much would be interest, how much would be principal, how much of it went into the reserve fund for insurance and taxes.

Other records that I gave was a list form that would show the individual cost of the homes and depreciation to be accounted.

Q. Did the company keep the records which you have suggested by tracts? A. Yes, sir.

Q. Did you have any idea how the preparation—rather, did you have anything to do with the preparation of the Federal income and excess profits tax returns of the Pacific Homes, Inc.?

A. Yes, sir; I prepared them.

Q. Did you prepare all of such returns that were filed by the plaintiff? A. Yes, sir.

Q. In connection with the preparation of such returns, did you examine the accounts to determine what data should go [39] into the returns?

A. I didn't hear the last part.

Mr. Wrixon: Would you repeat it, Mr. Reporter?

(Question read by the Reporter.)

The Witness: Yes, sir.

Q. (By Mr. Wrixon): Now, were the expenses concerned with the facts kept separate as well as the income from the rents on each of the tracts?

A. Yes, sir. That is, as to the direct expenses.

Q. I will refer you, Mr. Mabey, to Exhibit 2

(Testimony of Charles P. Mabey.)

attached to the stipulation, the exhibit being designated as "Rents Received From the Organization to the Liquidation of the Company," and I will ask you, did you prepare Exhibit 2? A. Yes, sir.

Q. And will you state to the Court—will you explain to the Court, rather, the figures on Exhibit 2?

A. The exhibit is broken down as between the tracts of Pacific Homes, Inc., and it shows gross rentals by taxable years and the expenses and the net rental for each of those tracts of Homewood, Southwood, Shoreview, Westwood, Bayshore Park, Morey Tract, and then totaled.

Q. Now, the figures at the bottom of the statement, the net rental income in the amount of \$89,799.08, will you state whether that net rental income includes any pro rata of the administrative expenses? [40]

A. No, it does not. Each subdivision had its tract office, and so the expenses that went into this schedule and also on the books of the corporation would be the expenses that arose in connection with the operation of that tract office as opposed to administrative expenses that would arise in the general office of the company.

Q. Well, now, what is the general nature of the expenses which are included within that caption, "Administrative Expenses"?

A. Well, for certain years, not all of them, depending on the business that the company was doing, there was an allocation of officers' salary, there were items like general office rent, depreciation on the office equipment, donations, any business promotion,

(Testimony of Charles P. Mabey.)

and the general office stationery, printing and office expense.

Q. Well, will you just explain to the Court why they were grouped under the heading "Administrative Expenses" instead of being allocated to the different tracts?

A. Well, we—it would have been rather difficult for that type of expense, for example your donations, office expense, to make a proper allocation between the tracts and also as between what would be rental, operation, and what wouldn't.

Aside from the operation of the tract itself, so far as accounting goes, and the general office help, salaries, [41] and so forth, there was the matter of owing the FHA payments, and there was new business promotion, which had nothing to do with rental operation.

Q. What is the effect, from an accounting standpoint, of failing to allocate any portion of the \$152,884.88 in administrative expenses to the various tract income?

A. Well, the net effect would be that you would throw more expense against the tract operation, and consequently reduce the net rental income by whatever amount had been allocated.

Q. Do you mean that if you would allocate some portion of the \$152,884.88 to various tracts it would reduce the net income shown for each tract on Exhibit 2?

A. Yes.

Q. Now, will you refer, please, to the fourth tract that shown on Exhibit 2, the Westwood Tract?

(Testimony of Charles P. Mabey.)

Will you state whether the houses in the Westwood Tract were originally owned by the plaintiff?

A. Originally, no, they were not owned by the plaintiff.

Q. What company, if you know, did own the houses in the Westwood Tract?

Mr. Blackstone: We stipulated it was purchased by Western Homes, Mr. Wrixon. I don't understand why we need go into this again.

Mr. Wrixon: Very well. I thought it was appropriate [42] to mention to the Court that there were some of these tracts, your Honor, which did not originate with the plaintiff in this case, but were some houses taken over by the plaintiff in order to liquidate the capital account of the other corporation which is also involved, Western Homes, Inc.

The Court: It is covered in the stipulation?

Mr. Wrixon: I think it is. Perhaps not in quite as much detail as I was going to ask, but I think substantially.

Q. (By Mr. Wrixon): Referring to the sixth tract listed on the statement, Mr. Mabey, the Morey Tract, how many homes were involved in this tract?

A. Forty.

Q. And will you explain why the rentals and expenses for this tract appear in only one column, that is, in the Fiscal Year ended May 31st, 1946?

A. Well, the ownership fell within all that one year, the houses being completed and rented and sold during that one fiscal year.

Q. Well, how were the proceeds from the sales

(Testimony of Charles P. Mabey.)

of the houses in the Morey Tract treated on the plaintiff's income tax return?

A. As a short-term capital gain—capital loss, excuse me, the Morey is.

Q. Morey?

A. That would be on the short-term gain. [43]

I think I'd better correct myself, your Honor. It is pretty difficult to keep these straight. The Morey Tract was a loss operation and would have been a short-term——

Mr. Blackstone: Just a minute. I move that be stricken. That is his conclusion. I don't object to his stating what was put on the return, but I certainly object to what the witness' conclusion, and if it is important, it is for your Honor to decide.

The Court: Is that a legal conclusion, if you know?

The Witness: On the return that was put that way, your Honor.

The Court: The objection will have to be sustained. You may develop it.

Q. (By Mr. Wrixon): In what manner was the results of the sale of the Morey houses shown on the income tax return of the plaintiff, if you recall?

A. What was the result?

Mr. Wrixon: Would you read the question, Mr. Reporter?

(Question read by the Reporter.)

The Witness: I am sorry, I don't understand the question.

(Testimony of Charles P. Mabey.)

Mr. Blackstone: I will stipulate that it is shown on the return, in the way we agreed it was reported, as a short-term capital loss on the tax return. Sales from the Morey Tract. There isn't any dispute about how they reported [44] it.

The Court: It is twelve o'clock. We will take a recess until two o'clock.

(Thereupon this cause was recessed until the hour of two o'clock p.m., this date.) [44-A]

Monday, December 13, 1954—2:00 P.M.

(Whereupon, following the noon adjournment, the witness Charles P. Mabey resumed the stand and testified further on direct examination by Mr. Wrixon as follows.)

Mr. Wrixon: If your Honor please, there is a matter mentioned in the stipulation in Paragraph 14 concerning the length of time the houses sold in the years 1945, 1946 and 1947 were held by the plaintiff. This question might be a little duplication, but I would like to ask it to clear up a point that isn't entirely clear in the stipulation.

The Court: Very well, proceed.

Q. (By Mr. Wrixon): Mr. Mabey, referring to the sales of houses made by the plaintiff out of the Homewood, Shoreview and Southwood Tracts, during the years, fiscal years, May 31st, 1945; May 31st, 1946, and May 31st, 1947, can you state whether all those sales of houses are represented by sales of houses owned for more or less than six months?

(Testimony of Charles P. Mabey.)

A. They were held more than six months.

Q. Can you state how they were reported on the income tax returns of the plaintiff?

A. As sales of long-term capital assets.

Mr. Wrixon: Now, if your Honor please, may I state for the record that Plaintiff's Exhibit 18, which is in evidence, [45] includes in addition to Form 1120, United States Corporation Income and Declared Value Excess Profits Tax Return, also attached as part of the exhibit Form 1121, Corporation Excess Profits Tax Return for the same fiscal period; that is, the period ending May 31st, 1945.

Q. (By Mr. Wrixon): Mr. Mabey, I will show you Plaintiff's Exhibits 18, 19 and 20, being the Federal income tax returns for the three years here involved; and I will ask you to look at them and state to the Court the place on those returns in which the rents and the rental expenses were reported.

A. They are on lines 4 and 5, "Gross Receipts (where inventories are not an income-determining factor)," and "Less cost of operations."

Q. And were the items of rental income and rental expense reported on the same lines of the income tax returns for each of the years ended May 31, 1945; May 31, 1946, and May 31, 1947?

A. Yes, they were.

Q. Now, will you state to the Court whether the income tax returns, Forms 1120, for each of the years here involved contains a line 10 upon which you report a certain item?

(Testimony of Charles P. Mabey.)

A. Line 10 is indicated as "Rents."

Q. Is that true on the income tax return forms for each of the years May 31, 1945; May 31, 1946, and May 31, 1947? [46]

A. Yes, sir.

Q. Were any of the amounts of rental income or rental expense applicable to the plaintiff for one or more of the fiscal years here involved reported on line 10?

A. No, sir.

Q. Well, will you state to the Court why items of rental income and expense were reported as you have testified, rather than reporting them on line 10?

A. Well, you look at the tax return, you know that you have rentals that must be reported, and just going down the tax return as to matters of income, we have on line 1, "Gross Sales (where inventories are an income-determining factor)," and it wouldn't seem as though the rentals would properly go in that space.

Then you look at line 4, "Gross Receipts (where inventories are not an income-determining factor)." We had the rentals, we had the offsetting expenses incident thereto, and since it would appear that that was the type of business that the company was in, the lines 4 and 5 would be the logical place to put them as opposed to, let's say, line 10, where I would look at it as being where an item of rent should go other than the type with which we are concerned.

Q. Well, I call your attention, Mr. Mabey, to Plaintiff's Exhibits 18, 19 and 20; and particularly to a number, "182," appearing opposite a title:

(Testimony of Charles P. Mabey.)

“Business Group Serial Number [47] (From Instruction N).” Will you explain to the Court the significance of No. 182?

A. Well, it is a number furnished by the—that is, the Code indicates by numbers certain types of businesses, and the person preparing the return is asked to indicate by that number the business that the taxpayer is in.

Q. And can you—excuse me, your Honor.

The Court: What business is he in?

The Witness: As to the matter of the tax return, your Honor, why, the number 182 would indicate they were operators and owners of improved real estate. That would be a number that you could select from in the instructions with the tax return itself.

The Court: Under what section?

The Witness: You mean the Code number?

The Court: Code number.

The Witness: I don't know that, your Honor. It is just an instruction sheet that comes with the tax return.

The Court: Proceed.

Q. (By Mr. Wrixon): Mr. Mabey, I will show you a form entitled “Instructions for Form 1120, United States Corporation Income Tax Return, 1946,” and I will ask you to examine the document which I hand you and state to the Court whether you have ever seen such a document before.

A. Yes, sir. They come each year with the blank form of [48] return sent out by the Bureau.

(Testimony of Charles P. Mabey.)

Q. And does the form which I have just handed you indicate the numbers that are used to designate the business in which the company is engaged?

A. Yes, sir.

Q. Is that the instruction sheet from which you selected the number 182 which you placed on the return? A. Yes, sir.

Q. And is there a corresponding sheet for each year which you examined in preparing the income tax returns of the plaintiff?

A. Yes, there would have been.

Q. And were the instruction sheets for corresponding years the same as the one which you have in your hand? A. Yes, sir.

Q. And in each case the number 182 indicated the same description of the type of business as has been testified to by you, is that correct?

A. It appears on each of these returns.

Mr. Wrixon: I offer in evidence, if your Honor please, "Instructions for Form 1120, United States Corporation Income Tax Return" for the year 1946.

The Court: Let it be admitted next in order.

(Whereupon document referred to above was received in evidence and marked Plaintiff's [49] Exhibit No. 22.)

(Testimony of Charles P. Mabey.)

PLAINTIFF'S EXHIBIT No. 22

Page 1

1946

Instructions for Form 1120

United States Corporation Income Tax Return

(References are to the Internal Revenue Code,
unless otherwise noted)

General Instructions

A. Corporations which must make a return on Form 1120.—Every domestic and every resident foreign corporation not specifically exempted by section 101, whether or not having any net income, must file a return. The term “corporation” is defined by the Code to include associations, joint-stock companies, and insurance companies.

Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and control over the business or property of a corporation, he shall be deemed to be operating such business or property, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation.

B. Period to be covered by return.—Returns shall be filed for the calendar year 1946 or fiscal year beginning in 1946 and ending in 1947. A fiscal

(Testimony of Charles P. Mabey.)

year is an accounting period of 12 months ending on the last day of a calendar month other than December.

* * *

182. Owner-operators of improved property and lessors of buildings.

183. Owners for improvement.

184. Trading for own account.

185. Agents, brokers, managers, etc.

186. Title abstract companies.

187. Lessee operators of improved property.

* * *

Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, are you able to tell from the plaintiff's records on which tracts houses were constructed by the plaintiff as compared with tracts on which houses were built by others and sold to the plaintiff? A. Yes, sir.

Q. Will you state to the Court what the records indicate in that respect so far as the Homewood Tract is concerned?

A. The Homewood Tract was improved by Pacific Homes.

Mr. Blackstone: May it please the Court, all this matter is stipulated to. What is the point of the question?

Mr. Wrixon: Merely to establish, Counsel, that the plaintiff itself constructed the homes in Home-

(Testimony of Charles P. Mabey.)

wood, and that is consistent with the application for—application to obtain the priorities; and it also explains the exhibit in the priority list which states that the houses were built for sale. It is merely to establish some of the houses were built and some were not built directly by the company.

Mr. Blackstone: Which ones are they, Mr. Wrixon?

Mr. Wrixon: The witness will testify, I think, that the houses in Shoreview and Southwood were not constructed by the plaintiff, but were acquired by the plaintiff from another builder upon completion.

Mr. Blackstone: All right, can't we stipulate to that? You never requested us to stipulate to that. I suppose it is a [50] fact. Go ahead. I am sorry to interrupt.

Q. (By Mr. Wrixon): Will you state to the Court what the records of the plaintiff show so far as the acquisition by the plaintiff of houses in the Shoreview Tract and Southwood Tract are concerned?

A. Well, they did not do the improvement and construction themselves on Shoreview and Southwood.

Q. Did the plaintiff purchase the houses from someone else who built them? A. Yes, sir.

Q. Will you state to the Court whether the records were maintained in such form as to indicate separately the rentals and expenses connected with the rental collections as compared with the sales of houses?

(Testimony of Charles P. Mabey.)

A. They were all kept separately.

Q. And what records were maintained in connection with each type of receipts?

A. Well, of course there was the general ledger account for rentals maintained separately as to the tracts. Then there were general ledger records for the sale of each home, also by tracts. Then there were underlying subsidiary records in connection with the sale of houses to show the transaction as it related to each individual house.

Mr. Wrixon: I believe that is all. [51]

Cross-Examination

By Mr. Blackstone:

Q. Mr. Mabey, directing your attention to Exhibit 2, which is entitled "Rents Received," and breaks down the rents received from the various tracts for the various fiscal years from 1943 through their fiscal year 1947, as I understand it, you were the one that prepared this schedule, is that correct?

A. Yes, sir.

Q. At the bottom of the schedule appears "Net Rental Income." Yet it appears, also, that you have not deducted from the net rental income any share of the administrative expenses, is that correct?

A. That's correct.

Q. Well, as an accountant, do you think that that is an accurate picture of net rental income to

(Testimony of Charles P. Mabey.)

report a figure which does not include the overhead expense?

A. Well, it would—could be deducted this way: Where you have these tracts involved, and where you have the company engaged in activities other than these tracts, or likely to have, it would seem to me it would give the management more information if they allocate the direct expenses of each tract, that is, the salary, let's say, of a tract manager.

Let me explain, perhaps: If that is expressed with relation to each tract for tract manager's salary, there is the interest that was paid on the FHA loan, there are the real [52] estate taxes on the loan, depreciation, the general office expenses of the tract, you have with that information which you know is definite, you have a more accurate figure to rely on than if you try to take these administrative expenses that, as the system is developed, applied to matters other than rentals. The allocation might bring into close relationship, but who is to say the allocation would be correct when there are other activities?

Q. Let me ask you this question: I am not an accountant, Mr. Mabey, but if a company is engaged solely in the business of renting houses in question, as an accountant, in figuring its net rental income, would you present a document which did not deduct from that its administrative expenses?

A. I can agree that seeing administrative expenses would be interesting, and probably try to find out if that administrative expense could be allocated as it would be more——

(Testimony of Charles P. Mabey.)

Q. What would there be to allocate among if you have a company engaged only in the business of renting property?

A. Well, as subsequent—in the first year——

Q. I think you could answer that question, Mr. Mabey.

A. I would like to explain with respect to this statement here, if I may.

Q. I am trying to get at that, but I think you could answer a question that was put to you directly. If you have a business which is engaged solely in the rental business, isn't [53] the correct way to find out the net income from the business and deduct all expenses, overhead as well as the direct expenses?

A. That would be proper.

Q. That would be correct? A. Yes.

Q. But you say in this case that you could not deduct part of the expenses that should be attributed to rental income because there were other operations the business was carrying on, is that correct?

A. In this respect: For example, the accounting attention that would be required to service FHA loans and so forth, do you feel that that should be charged against rental operations? That is one thing that would make allocation difficult. And a large part of whatever would be involved in payment of monthly FHA loans on all these houses, just as an item for example.

Q. Isn't the reason, Mr. Mabey, you didn't show allocations between administrative expenses to rental

(Testimony of Charles P. Mabey.)

income is because the company was also engaged in the business of selling houses?

A. Let's take this schedule. Well, it wouldn't show on this rent received schedule, but one of these sub-sections. Naturally when houses appear in this schedule as having been sold, some of that overhead expense, if you wish to throw it back, some would have to go against rental, some would have to go against [54] that other property.

Q. The other operation we are dealing with here is a selling operation, is it not? Look at Exhibit 3.

A. On Exhibit 3, you readily see you have a rental operation. You have some of this general expense that must apply against the houses sold, also. Yes, very definitely.

Q. And the reason why you did not allocate the administrative expense is because this company was engaged not only in a rental operation, but in a selling operation, is that not a plain fact?

A. In that regard, that very definitely—See that first one, now, I wouldn't know how much of this administrative expense should go against rental, how much should go against sales, or how much would apply to something else, that is true.

Q. Directing your attention, Mr Mabey, to the tax returns that have been introduced in evidence—I believe they are Exhibits 18, 19 and 20—did you prepare the entire return, including the caption? I notice here under “Kind of Business” in Exhibit

(Testimony of Charles P. Mabey.)

18 it says, "Development of Subdivision, Renting and Selling Homes to Defense Workers."

Is that your language on the return?

A. I think so. I think my signature would be on the tax return, and anything that I didn't have in my own handwriting at least would be my responsibility.

Q. Well, at the time you prepared this, I assume you considered [55] that was an accurate description of what business the corporation was engaged in, is that correct?

A. I think so, if I put it there.

Q. I find that on Exhibit 19, the tax return for the year ending May 31st, 1946, the kind of business is given as, "Development of Subdivision, Renting and Selling Homes."

Here again I find your signature on the tax return, and I take it that is your language that you used in describing the business of the corporation?

A. I would say so.

Q. And Exhibit 20, which is the tax return for the year ending May 31st, 1947, under "Kind of Business," I find there appears "Development of Subdivision, Renting and Selling Homes." That is again yours? A. That sounds like me, yes.

Q. Mr. Mabey, I should like to show you a certified photostatic copy of an income tax return for this corporation for the period ending May 31st, 1942. Do you recognize this as having been prepared by you for this corporation?

(Testimony of Charles P. Mabey.)

A. Yes, sir, I am sure it is mine. It has my signature on it.

Mr. Blackstone: I should like to introduce in evidence as Defendant's Exhibit A this document.

The Court: For what purpose?

Mr. Blackstone: I should like to establish that in 1942 [56] the corporation represented its business as that of construction and sale of defense homes, which I think bears on the issue of what kind of business this corporation was in.

The Court: It will be admitted and marked for the limited purpose of the offer.

(Whereupon income tax return for period ending May 31st, 1942, was received in evidence and marked Defendant's Exhibit No. A.)

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN

1941

For Calendar Year 1941

or fiscal year beginning June 1, 1941, and ending May 31, 1942

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.
(Name)

859 SAN MATEO DRIVE
(Street and number)

SAN MATEO, SAN MATEO, CALIFORNIA
(City) (County) (State)

Kind of business: Construction & Sale of Defense Homes

Business group serial number (from Instruction N) 193 and 182

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

Item and Instruction No.

1. Gross sales (where inventories are an income-determining factor) \$..... Less: Returns and allowances \$.....

2. Less: Cost of goods sold. (From Schedule A) \$.....

3. Gross profit from sales \$.....

4. Gross receipts (where inventories are not an income-determining factor) \$.....

5. Less: Cost of operations. (From Schedule B) \$.....

6. Gross profit where inventories are not an income-determining factor \$.....

7. Interest on loans, notes, mortgages, bonds, bank deposits, etc. \$.....

File Code

1095-

Serial No.

210479

District

(Cashier's stamp)

Cash

Check

M. O.

First Payment

Q. (By Mr. Blackstone): Mr. Mabey, I show you—I should like you to identify a certified copy of the corporation's return for the year ending May 31st, 1943, for Pacific Homes, Inc., and ask you if you prepared that return?

A. Yes, sir, I can identify that as mine.

Mr. Blackstone: Thank you. I offer this in evidence as Defendant's Exhibit B for the purpose of showing that for the year ending May 31st, 1943, the corporation described its business as "Construction and Sale of Defense Homes."

The Court: It will be admitted and marked.

(Whereupon document referred to above was received in evidence and marked Defendant's Exhibit B.)

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN

For Calendar Year 1942

or fiscal year beginning June 1, 1942, and ending May 31, 1943

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES INC.

(Name)

859 San Mateo Drive

(Street and number)

San Mateo, San Mateo, California

(State)

(Post office)

Kind of business: Construction and Sale of Defense Homes.

Business group serial number (from Instruction N) 193 and 182

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor) \$ 4,566.23

2. Less: Cost of goods sold. (From Schedule A)

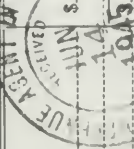
3. Gross profit from sales

4. Gross receipts (where inventories are not an income-determining factor) \$ 83,470.50

5. Less: Cost of operations. (From Schedule B) 69,233.27

6. Gross profit where inventories are not an income-determining factor

7. Interest on loans notes mortgages bonds bank deposits etc.



23
39
84

14,237.23
1,104.17

1942

File Code 565

Serial No.

District

(Cashier's stamp)

Cash Check M. O.

First Payment

\$

AUG

2910974

9/27/45

8908

8 11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

11/29/45

(Testimony of Charles P. Mabey.)

Q. (By Mr. Blackstone): Now, Mr. Mabey, I ask you to look at the tax return for the year ending May 31st, 1944, for Pacific Homes, and ask you if you prepared that return. [57]

A. Yes, sir.

Mr. Blackstone: May I ask that this be admitted into evidence as Defendant's Exhibit C.

The Court: It will be admitted next in order.

Mr. Blackstone: The purpose being that it states on the face of the return, "Kind of Business: Development of Subdivision, Renting and Selling Homes to Defense Workers."

(Whereupon document referred to above was received in evidence and marked Defendant's Exhibit C.)

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN

1943

For Calendar Year 1943

or fiscal year beginning June 1, 1943, and ending May 31, 1944

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.

(Name)

1182 Market Street

(Street and number)

San Francisco, California

(City or town)

(State)

Kind of business: Development of Subdivision - Renting and Selling Homes to Defense Workers

Oct. 15, 1944

Business group serial number (from Instruction N) 182

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor)

2. Less: Cost of goods sold. (From Schedule A)

3. Gross profit from sales

4. Gross receipts (where inventories are not an income-determining factor)

5. Less: Cost of operations (From Schedule B)

6. Gross profit where inventories are not an income-determining factor

7. Interest on bonds, notes, mortgages, bonds, bank deposits etc

Less: Returns and allowances

\$ 135,563.37
112,245.10

File Code

565

Serial No.

410090

District

(Cashier's stamp)

Cash

Check

M. O.

First Payment

Item and Instruction No.

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor)

2. Less: Cost of goods sold. (From Schedule A)

3. Gross profit from sales

4. Gross receipts (where inventories are not an income-determining factor)

5. Less: Cost of operations (From Schedule B)

6. Gross profit where inventories are not an income-determining factor

7. Interest on bonds, notes, mortgages, bonds, bank deposits etc

23,318.27
3,129.48

108

Q. (By Mr. Blackstone): Returning now, Mr. Mabey, to this Exhibit 2, the analysis of rents received, you would agree, I take it, that the net rental income figure there is then definitely overstated if one were interested in finding out what the actual, true net rental income of the corporation is after deducting whatever share of administrative expenses is proper?

A. Yes, I think that is accurately stated.

Q. And likewise on Exhibit 3, you would say that the profit on the sales shown there is likewise overstated because from an accounting point of view, certainly some of the amount of administrative expense not attributable to rental received should be accounted to the selling of the property, is it not?

A. That was my purpose for putting the note there at the bottom. [58]

Q. In other words, you yourself did not feel you had enough information to decide in what way the allocation of administrative expense should be made, is that correct? A. That is right.

Q. But you did recognize, certainly, some of it should be attributable to rental operations and some of it should be attributable to selling operations, is that correct? A. Yes, sir.

Q. Turning to Exhibit 4, Mr. Mabey, which is entitled "Investment in Real Property and Notes and Mortgages Payable," I take it you prepared that exhibit also? A. Yes, sir.

Q. Is it possible for you as an accountant to decide from looking at these exhibits here, Exhibit 4.

(Testimony of Charles P. Mabey.)

which is the investment in the real property, and Exhibit 2, which is the profit from the real property—or which is the rental analysis—to decide what the return on the investment was insofar as rental operations were concerned? By that I would mean what accountants I suppose would call the yield on investments.

A. It seemed to be quite clear that the percentage would be fairly low. Did you want me to try to state what that per cent would be?

Q. Yes, and if you could explain. I would take it in figuring the percentage you would not, for example, starting with the [59] first period ending May 31, 1942, Exhibit 4 shows there is something a little over \$225,000 invested in improved property; Exhibit 2 would indicate a net rental income of \$14,000, but to which you would apply some formula for administrative expense?

A. They are different years. There is no May 31st, 1942, on the first schedule.

Q. I see. Then the first one you could make an analysis on would be for the year ending May 31st, 1943, is that correct? A. That is correct.

Q. And would you explain how one would attempt to figure out the yield on the investment, looking solely from rental income point of view for that year?

A. Well, as I get the question, it would look like 2 per cent plus.

The Court: I can't follow that. What do you mean by that?

(Testimony of Charles P. Mabey.)

The Witness: Well, your Honor, the investment is \$644,000, and the net rental income for that year was \$14,000, so the fourteen thousand would be 2 per cent something, wouldn't it?

Q. (By Mr. Blackstone): And that is, however, figuring without attributing to the rental income any share of the administrative expense, is that correct?

A. Yes. [60]

Q. I see that the administrative expense total for that year was \$16,000. So that if this company had been doing nothing but a rental business, they would have lost money for that year, isn't that correct?

A. Yes.

Q. And there would then, of course, be no return whatsoever on the investment for that year?

A. That is right.

Q. For the year ending May 31st, 1944, could you give an estimate of what the yield would be without taking into account the pro rata share of administrative expenses?

A. Well, it looks like it would probably run about two and one-half per cent.

Q. But I see for that year there are \$15,000 or more in administrative expenses, so that if all of that were attributed to rental income, that would approximately reduce by half the yield you stated, is that correct?

A. Yes, sir.

Q. It would be a little over one per cent, then?

A. That's right.

Q. For the year ending May 31st, 1945, Exhibit 4 indicates \$996,000 plus as the investment, and Ex-

(Testimony of Charles P. Mabey.)

hibit 2 indicates a net rental income of \$33,000. Roughly speaking, what would that yield be?

A. Well, that one would run three per cent or better. [61]

Q. But then, directing your attention to the administrative expenses that were not allocated of \$20,000, if that were attributable to rental income, what would the yield on the investment be, approximately?

A. Oh, one and one-half per cent, one and three-tenths, somewhere around there.

Q. And for the year ending May 31, 1946, Exhibit 4 indicates something over \$263,000 invested, and Exhibit 2 indicates a net rental income of \$12,936. Now, what would you estimate the yield would be from those figures?

A. Looks like it would run six per cent.

Q. I see for that year, 1946, their administrative expenses of \$58,000 which, if all were attributable to rental income, would wipe out any income whatsoever for that year, would it not?

A. Yes, sir.

Q. Which would mean there would be absolutely no yield whatsoever on the investment of \$263,000 for that year, is that correct?

A. That is correct?

Q. Do you as an accountant know or have some opinion as to what the yield should be on rental property, what a landlord ordinarily expects to earn on money invested in his real property?

A. I haven't gone into that as an accountant,

(Testimony of Charles P. Mabey.)

particularly, or [62] in connection with my work. But as speaking of a return on any investment, I guess the risk element is involved. But aside from all of that, five or six per cent, anyway, would seem to be a figure that anyone should look for.

Q. Have you ever heard of a formula used by landlords of receiving in rent approximately one per cent per month of the amount invested in real property?

A. Oh, I couldn't really answer that.

Q. Mr. Mabey, I am interested in your testimony in regard to those sales from this Morey Tract, so-called, which occurred in the fiscal year ending May 31st, 1946. That sale of those houses resulted in a loss of \$9,561, is that correct? It appears here on Exhibit 3.

A. Yes, sir.

Q. Could you explain the reason for your reporting that on the income tax return as a short-term capital loss?

A. The fact that the houses were held for a period less than six months.

Q. You did not consider that these houses were houses used in the trade or business of the Pacific Homes Company?

A. Well, I think in effect the over-all treatment or determination that the same basis was used, that is, the only determination being whether the house was held over six months or less than six months, both as to the Morey Tract and the other subdivisions. [62-A]

Q. Well, may I put it this way: May I ask you

(Testimony of Charles P. Mabey.)

upon what information you were relying to treat these sales after a period of six months as sales of capital assets or assets held for investment?

A. What basis I was using?

Q. Yes. What facts did you have? What information did you have which caused you to treat the sales in this way?

A. Well, the fact that they were—the houses were subject to depreciation, and the fact that they were not—at least I did not consider them as being part of the company's inventory on the basis—or, in other words, if they had been inventorable items, that would mean they were considered primarily for sale, which was not the interpretation that I used in the preparation of the tax returns.

Q. Well, what information did you have that these houses were not held for sale? The fact is they were all sold within a six months period, isn't that correct?

A. On the Morey Tract?

Q. Yes, on the Morey Tract. A. Yes.

Q. We are talking about the Morey Tract.

A. Yes, sir. To me in preparation of tax returns, the fact that they were held less than six months, the whole question was just academic in that it didn't enter into the capital gain, tax capital gain computation for the other houses. [63]

Q. Well, can I interpret that then to mean that you didn't really make any specific inquiry of anyone in the corporation as to the exact nature of their business relating to the houses, that you felt it didn't really make any difference whether it was

(Testimony of Charles P. Mabey.)

reported as a short-term capital loss or as an ordinary business loss?

A. To me the—as I remember the Code there, the short-term loss acts as a reduction of the long-term gain in the computation and didn't affect the tax picture at all. So, so far as I was concerned, my questions would be answered in connection with the preparation of the return.

Now, as to what the intention was with regard to these Morey houses, I would have no more information than what the management perhaps would have told me at the time. Whether or not I put any question to them, I do not recall.

But in answering your question now, I don't think that it would have made any difference in the preparation of the tax return whether they said it had been held primarily for sale or for rent. The treatment still would have been the same.

Q. If these houses, then—your understanding of the tax laws would be that if these houses were used in the trade or business of Pacific Homes, Inc., that it was then proper to treat a sale of them, when it results in a loss, as a short-term capital loss. [64]

A. If it is used in the trade or business?

The Court: Is that the question?

Mr. Blackstone: Yes.

The Witness: I didn't get the full significance in order to answer the question. I am sorry.

Q. (By Mr. Blackstone): Well, was your understanding of the tax law that it is a proper tax treatment to report as a short-term capital loss a

(Testimony of Charles P. Mabey.)

sale of property used in the trade or business which resulted in a loss.

A. To treat it—give it the capital gains and loss treatment, yes, sir.

* * *

ROSS H. CHAMBERLAIN

was called as a witness on behalf of the plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

The Court: State your name, please.

The Witness: Ross H. Chamberlain.

The Court: Where do you reside?

The Witness: Woodside. [65]

The Court: Your business or occupation?

The Witness: I am a contractor.

The Court: How long have you been so engaged?

The Witness: 17 years.

The Court: Take the witness.

Mr. Wrixon: If your Honor please, it is in the stipulation that the witness was one of the three incorporators of the plaintiff corporation, and that he was a director of the plaintiff corporation from the inception until the dissolution and winding up of the corporation; that he was secretary and treasurer from January 30, 1942, up until January 4, 1945; that from January 4, 1945, until the dissolution of the corporation the witness was president of the plaintiff.

It is also in evidence that he was one of the two shareholders during the entire existence of the

(Testimony of Ross H. Chamberlain.)

corporation, and from and after May, 1945, the witness was the sole shareholder of the plaintiff.

I say that merely to indicate that I will dispense with the usual questions laying foundation for what I am about to ask him.

Direct Examination

By Mr. Wrixon:

Q. Mr. Chamberlain, did you take any part in the management of the affairs of the Pacific Homes, Inc.? [66] A. Yes, sir.

Q. And over what period did you participate in the management of the plaintiff's business?

A. From its inception to its dissolution.

Q. And what was the nature of your services to the plaintiff over that period of time?

A. I was officially secretary and treasurer, and I generally managed its activities prior to the renting of the houses, and I participated in financial decisions and things like that.

Q. Well, did you take any part in determining whether the plaintiff would engage in the building of houses in a certain tract or not? A. Yes.

Q. What investigation, if any, was made on behalf of the plaintiff before deciding to construct or acquire houses in a certain tract?

A. Well——

The Court: Speak up louder.

The Witness: Pardon me?

(Testimony of Ross H. Chamberlain.)

The Court: Raise your voice to help the Reporter.

The Witness: Do you want the whole story?

Q. (By Mr. Wrixon): Yes. Tell it completely, sir.

A. These houses were built during the period of the War, and at that time the only construction that could be legally [67] undertaken was construction which had priority assistance.

The priority assistance was given the construction industry in general regardless of whether the projects were private or for the account of the Government by the Office of Production Management, which was the prototype of controlling organization, or later the War Production Board, which was the successor to the Office of Production Management.

The first tract that I participated in on a priority basis was the Homewood Tract in Sunnyvale. The initial impetus to construct that tract and all of the others came from this Federal office, first the OPM and secondly the WPB, who got in touch with qualified developers and suggested that accommodations for war workers in certain areas were necessary.

When we were approached on the subject of building houses in Sunnyvale, we went to Sunnyvale and discussed the employment situation and the housing situation with employers in the neighborhood, who were largely of Joshua Hendy Ironworks and Woolridge Company, and we established to our

(Testimony of Ross H. Chamberlain.)

own satisfaction that there was a demand for dwelling houses in the area, and then we looked around to see where a suitable land was available to build them on.

Then when that was determined, we went to the War Production Board, or OPM, as the case may be, and told them if they would grant us priority assistance for a certain [68] number of houses, we would be happy to build them.

Q. And was that procedure which you have just described followed not only in the case of Homewood but in the other tracts as well?

A. I would say that it was typical.

Q. And in considering whether you would build in a certain tract, did you give any consideration to the prospective rents and the prospective expenses that would be involved in the operation?

A. Well, we knew what the rent was going to be because that was fixed by law. And we knew what the expenses were going to be insofar as they related to the mortgage because the amount of the mortgage was also fixed by law.

And the answer to your question is that if the rent, for instance, was \$50 a month and the amount that had to be repaid on the note was \$40 a month, there was a theoretical gross profit of \$10 per month per unit.

Q. Well, now, calling your attention, Mr. Chamberlain, to the Southwood Tract, what did the Pacific Homes, Inc., intend to do with the Southwood Tract when it was completed?

(Testimony of Ross H. Chamberlain.)

Mr. Blackstone: I object to his asking about the intention of the Corporation.

Mr. Wrixon: If your Honor please, I submit that is one of the questions which is involved in the case. And I have some authorities here that indicate where the matter of intent [69] is the issue in the case, the witness is competent to testify to the intention.

Mr. Blackstone: That may be, your Honor, if you are dealing with an individual. An individual could testify as to his own intent. But we are dealing with a corporation, which necessarily acts through people, and it would be for your Honor to decide completely what the intent of that legal entity is, and I don't think Mr. Chamberlain is in a position to state what the intention of the corporation is.

Mr. Wrixon: I submit, your Honor, a corporation functions only through natural persons, and natural persons who are here and who participated in the deliberations that went into this operation are competent to testify what the intention was in respect to which the units were built.

Mr. Blackstone: The most he could testify to would be his own intention. I don't see how he can say just what the corporation intended.

The Court: I should like to have you indicate what authority you have for your position.

Mr. Wrixon: If your Honor please, I have reference to a case in the Ninth Circuit, Hedderly vs. United States, 193 Fed. That, however, is a criminal case, but the language I think is significant.

(Testimony of Ross H. Chamberlain.)

The Court at Pages 570 to 571 said this. I am quoting:

“These questions were of the same character as [70-71] the question that was admitted over objection in the case of *Van Gesner vs. United States*, 153 Fed. 56, 82 CCA 180. In that case this court in passing up the admissibility of such testimony said——”

If I may say, your Honor, this is a further quotation from the United States Supreme Court in the case of *Williamson vs. United States*, 207 US 425.

The Court: Another criminal case?

Mr. Wrixon: Yes, your Honor. At Page 450 the Court said:

“The issue being the existence of a conspiracy to suborn various persons to commit perjury in relation to declarations to be made under the Timber and Stone Act as to the purpose for which they desired to acquire land, etc., and as it is conceded that no formal contracts were executed between the alleged conspirators and the proposed entrymen, and the alleged understandings were of an ambiguous nature, and the proof of the conspiracy depended upon a variety of circumstances, going to show the motive or intent, we think it was proper to permit the interrogation of the entrymen concerning their understanding of the agreement with *Van Gesner* and their intention at the time when they made their preliminary declarations, as the question [72] was relevant to the question of the nature and character

(Testimony of Ross H. Chamberlain.)

of the dealings of the entrymen with the alleged conspirators, and bore on the question of the purpose or motive which influenced the making of the sworn statement required by law as a condition precedent to the acquirement of the land.”

The Court: I agree with all of those criminal cases. Have you a civil case?

Mr. Wrixon: Yes. *Fanning vs. Green*, 156 Cal. 279. The Court at page 285 said—and this is a case relating to an action between the administrator of a wife’s estate and the plaintiff who was suing to quiet title. The question was whether there had been an intent to make a division between the husband and wife during their lifetime, and the Court at Page 285 said:

“It is well-settled that, under our system a witness may be examined as to the intent with which he did a certain act, where that intent is a material thing in the action. A jury or trial judge is not bound, of course, to believe the witness when he says he did not have a certain intent, and may find in the circumstances, acts, and language, an entirely different intent, but the testimony of the witness is competent and relevant and not immaterial.”

I would like to quote one further extract from Mr. Wigmore [73] on evidence. Wigmore 714-721, Section 581, Third Edition, 1940. The conclusion of Mr. Wigmore is that,

“Such testimony is clearly admissible when it is an issue in the proceeding as to what the intent actually was.”

(Testimony of Ross H. Chamberlain.)

If I may read——

Mr. Blackstone: May I say this——

The Court: Pardon me. What the intent of the corporation was?

Mr. Wrixon: The extract does not distinguish or make reference to whether it was a corporate intent or individual intent.

The Court: Well, we will concede there is a distinction, is there not?

Mr. Wrixon: I think, your Honor, that my original statement was that the intent of the corporation can be demonstrated only through the people who participated in determining the policy of the corporation.

The Court: Intent or intention may be manifested by the circumstances.

Mr. Wrixon: That is correct.

The Court: Develop them and I will give you a record on your position. I will allow it to go in subject to motion to strike and over your objection.

Mr. Wrixon: Thank you. [74]

Q. (By Mr. Wrixon): Will you state to the Court what was intended by the plaintiff in the construction of the Southwood homes?

Mr. Blackstone: What do you mean? Are you asking for his intention or the Corporation's?

Mr. Wrixon: The Corporation's intention.

Mr. Blackstone: Then, I am, of course, objecting, your Honor.

The Witness: The Corporation had a choice. It

(Testimony of Ross H. Chamberlain.)

could sell or it could rent, and the corporation chose to rent. So far as I am concerned, that was its intention, also. The intention was obligatory on the Corporation after the act.

The Court: I didn't get the last part of your answer, Mr. Chamberlain. After the what?

The Witness: After the act of construction.

The Court: Pardon me. Would you read that last part of his answer, Mr. Reporter?

(Answer read by the Reporter.)

The Court: Proceed.

Q. (By Mr. Wrixon): Well, will you describe, Mr. Chamberlain, the operation of Pacific Homes as actually carried out in the Southwood Tract after the houses were completed?

A. The Southwood Tract was constructed in the latter part of 1943 and early part of 1944. By that time the pattern of the business operation had been pretty well established. After [75] we received permission from the War Production Board and were granted priorities, the business of developing the land in a manner so that it was suitable for the construction of dwelling houses was undertaken, and then the construction of the dwelling houses was actually started on.

The first building on any one of these tracts was also used as a tract office. It housed the tract manager, and it is where the solicitation of rentals occurred.

The tract manager was generally selected from

(Testimony of Ross H. Chamberlain.)

an individual who was already living in another tract and was interested in becoming a tract manager.

The tract manager's duties included not only signing the leases on behalf of the Company, but also included the duties of collecting overdue rent and reporting to the Company complaints, requests for service, and so forth.

Mr. Wrixon: You mentioned requests for service. Would you explain to the Court what you mean by that, please?

A. Well, inasmuch as these people were renters, everything that happened to the house we had to take care of from leaky faucets and leaks in roofs and chimneys, to door knobs, and doors that don't close and paint that is marred, and so forth.

Q. And did the Corporation perform that type of service at the request of the tenants?

A. Oh, yes. We didn't repair windows that their children threw baseballs through, but if it was something of a structural [76] defect, we took care of it.

Q. Going on to the—I will withdraw that.

What change, if any, occurred in the operation of the Southwood Tract as you have just described it after the tract was completed and rented?

A. No change.

Q. Going now to the Shoreview Tract, what was the intent of the plaintiff in the acquisition of houses in the Shoreview Tract?

Mr. Blackstone: I object to the question on the

(Testimony of Ross H. Chamberlain.)

grounds previously urged. Question as to the intent of the Corporation.

The Court: What was the question again?

(Question read by the reporter.)

Mr. Blackstone: My objection is on the ground it is asking for the intention of the corporate entity rather than the intention of an individual.

The Court: What is the purpose of the question, Counsel?

Mr. Wrixon: The purpose of the question, your Honor, is again to establish the intent and purpose in the acquisition of these houses, which is one of the issues in the case.

The Court: We are dealing with a corporation, that is the only difficulty I have. If he knows and can speak for the Corporation or its members, he may do so in relation to their intent. [77]

Mr. Wrixon: That is the purpose of my question, to establish through this witness what that corporate intention was.

The Court: Very well, you may answer.

The Witness: The intent at Shoreview was the same as I have described in connection with Southwood.

Q. (By Mr. Wrixon): Will you state it for the Court?

A. We were solicited by the War Production Board to acquire that land and build houses on it because they needed houses at Mills Field—needed houses for Mills Field employees, I should say.

(Testimony of Ross H. Chamberlain.)

So the same thing is a duplication. We started to build houses and we built them, and we rented to mostly employees of airlines—anyway, somebody at Mills Field.

Q. (By Mr. Wrixon): Did the plaintiff perform the same type of maintenance services for the Shoreview Tract houses that it did for the Southwood tract houses? A. Yes.

Q. In the case of Shoreview, do you recall whether there was a sale of some seven houses out of the Shoreview Tract during the time the houses in that tract were being built? A. Yes.

Q. Can you explain to the Court the circumstances surrounding the sale of those seven houses?

A. One of the houses was sold to one of our employees who [78] insisted on buying it. All of them were in the area that the State of California had indicated—did condemn for purposes of building an overpass and appurtenant structures.

Q. And what change, if any, occurred in the operation at the Shoreview Tract as compared with the operation at Southwood? A. None.

The Court: Take a recess.

(Short recess taken.) [79]

Mr. Wrixon: Mr. Reporter, will you be kind enough to read the last question?

(Question and answer read by the Reporter.)

Q. (By Mr. Wrixon): Mr. Chamberlain, I will show you Plaintiff's Exhibit 12, being the application to the Office of Production Management relating to Homewood, and being an application re-

(Testimony of Ross H. Chamberlain.)

lating to 175 houses, and I will ask you, did you have anything to do with the preparation of Plaintiff's Exhibit 12? A. Yes, I prepared it.

Q. And that is an application for priority assistance with respect to 175 houses to be built for sale, is that correct? A. Yes, sir.

Q. The houses, 175 houses, were actually built at the Homewood Tract, is that correct?

A. Yes, sir.

Q. Did the original intention to build those houses for sale continue, or was it changed?

Mr. Blackstone: I object to the question again on the ground it is asking this witness to testify as to the intention of a corporation. That intention must be ascertained from all the circumstances and can't be testified to directly.

The Court: This is the same objection?

Mr. Wrixon: Yes, your Honor, as I understand it.

The Court: I will allow it to go in subject to your [80] motion to strike and over your objection. You may answer.

The Witness: The intention of the management and Board of Directors of the Corporation was to construct houses for rent in Sunnyvale rather than construct houses for sale.

Q. (By Mr. Wrixon): What was actually done with the houses in the tract after they were constructed? A. They were rented.

Q. And as the plaintiff attempted to rent the houses, what was the plaintiff's experience in that regard?

(Testimony of Ross H. Chamberlain.)

A Its experience wasn't so good. We had lots of trouble renting the houses, and as a result we used the device of renting with an option to purchase.

This option to purchase was entered into in the Homewood Tract for the twofold purpose of inducing people to rent the houses, and also to encourage them to take an interest in the property that they were inhabiting with the hope that they would take better care of it.

Q. What was the plaintiff's experience in renting the houses with an option in the tenant to purchase?

A. The experience? You mean whether we were able to rent them?

Q. Yes, was the purpose to rent the houses after the giving of an option to the tenant to purchase?

A. Yes, sir.

Q. And did the plaintiff offer that type of lease uniformly [81] to all the prospective tenants?

A. Yes, they did.

Q. Well, did vacancies occur in the Homewood Tract from time to time? A. Yes, they did.

Q. And when the vacancies occurred, did plaintiff lease the premises at any time to tenants without an option to purchase?

A. I don't believe so. That is, to the best of my knowledge all of the leases were exactly the same. Now, it is possible that at the very end of the operation there might have been some straight leases. However, I don't remember any.

The Court: With an option to buy?

(Testimony of Ross H. Chamberlain.)

The Witness: No, sir, just a lease like you would have on an apartment. But whether any of those were entered into or not, I can't say. I don't remember.

Q. (By Mr. Wrixon): Now, describe what was done in the Homewood Tract with respect to the operation there insofar as the tract manager was concerned, and the other things that were done by the plaintiff in order to rent the homes.

A. The Homewood Tract was the first tract and therefore could be considered to be the prototype of all of the other tracts.

We built a house there and hurried up and finished it up and installed therein a tract manager.

This was the only small tract that had a male manager, and [82] he performed the functions that I have described before as the duties of the tract manager. He supervised the leasing and entered into the leases on behalf of the company, and took care of complaints, and collected delinquent rents, and so on.

Q. Did he also take care of any maintenance or repair requests made by the tenants?

A. Yes. And inasmuch as he was a man, minor things he took care of himself, and of course major things were referred to the company for service correction.

Q. Well, from time to time after the—I will withdraw that.

Will you state to the Court, Mr. Chamberlain, why some of the houses in these tracts, Shoreview,

(Testimony of Ross H. Chamberlain.)

Southwood and Homewood, were sold by the corporation?

Mr. Blackstone: Just a minute. I object to the form of the question, why some of them—they were all sold, your Honor. That is a pretty vague question.

Mr. Wrixon: Well, if your Honor please, I will withdraw the question and reframe it. What I had in mind, the houses were not all sold at one time.

Mr. Blackstone: That is stipulated to.

Mr. Wrixon: My purpose in asking the question was merely to have the witness explain to the Court why the houses were sold, if they were, so I will withdraw the question.

Q. (By Mr. Wrixon): Explain to the Court, Mr. Chamberlain, [83] why the houses in the three tracts, Shoreview, Southwood and Homewood, were sold?

Mr. Blackstone: Just a minute. Your Honor, I object to the form of the question.

The Court: Why they were sold? The ultimate fact is that they were sold period.

Mr. Wrixon: Yes.

Mr. Blackstone: It is apparent in the stipulation the majority of the houses were sold because apparently there was an option to buy in the tenant. The Corporation didn't have any control over that in one way or the other.

Mr. Wrixon: That is true, your Honor, as to houses that were sold to tenants who had an option to buy, that was a matter beyond the control of the

(Testimony of Ross H. Chamberlain.)

Corporation. But as to houses which were sold non-option tenants, let us call them. I think it is proper that the witness be allowed to explain to the Court why those houses were sold.

The Court: And the purpose of that offer is what?

Mr. Wrixon: The purpose is, your Honor, to show the circumstances under which the sales were made, and to show that they were not made in the manner in which the ordinary real estate subdivision selling operation sells property.

The Court: How many were sold that way, if you know?

Mr. Wrixon: The exhibits will show, your Honor. I wouldn't want to state them from memory, but they are in [84] evidence as exhibits attached to the stipulation.

The Court: In the interests of time, I will allow it to go in subject to your motion to strike.

Mr. Wrixon: Would you mind reading that question, Mr. Reporter?

(Question read by the Reporter.)

The Court: Reframe your question.

Q. (By Mr. Wrixon): Mr. Chamberlain, confining your answer to the houses which were sold in the Shoreview, Southwood and Homewood Tracts to persons who did not have an option to purchase, will you explain to the Court why those sales were made by the Corporation?

A. Well, in the Shoreview Tract there were

(Testimony of Ross H. Chamberlain.)

seven houses sold at the inception, one of which was sold to one of our most valued employees at his request.

The others were sold because the State Highway Department had decided to put an overpass that exists there now at that place. And the rest of the houses in Shoreview were sold, oh, two or three years later over a period of time as people came in and wanted to buy them.

In Homewood, I don't remember any sales being made right away. And the rest of the sales were made in the same way, as people that had these option contracts anticipated them or at the very last part of the operation as they became vacant and the individuals wanted to buy them instead of rent them. [85]

In the Southwood Tract it was the same thing. A lot of those houses became vacant toward—in 1945, in the spring, and the people that rented them or rented them with these options to buy, as they became vacant, why, they were sold also.

One of the main reasons for selling all of these houses was the terrible way the tenants treated them. As I mentioned before, there was a very narrow margin of gross profit. It was only—it never exceeded \$10 a house. I believe it was less than that. And some of these people would do \$100 worth of damage. There was those that would go out of the house and take everything they could unscrew. And they always moved out in the middle of the night.

Gosh, the hardware was off and anything they

(Testimony of Ross H. Chamberlain.)

could take. Even silly things like toilet seats. Who would want a toilet seat without the rest of it? But they took it because they could get it. It was awful. It was awfully expensive.

I felt the Company was morally bound to put the house in as nearly the same condition for the next person that came and rented under this purchase option system as the first one, so that meant we had to repaint them and fix them all up, and it ran into a lot of money. In the big tracts we had service departments with two or three men in them that didn't do anything but go around fixing up after these withdrawals.

The Court: Would the tax situation take care of any [86] of these matters you have just recited?

The Witness: If we had made any money, it would have.

Mr. Wrixon: They are reflected in the expense, your Honor, that are shown in the exhibits.

The Witness: I got to rambling there. I don't know whether I answered the question or not. I am sorry.

Q. (By Mr. Wrixon): Were there any other factors which influenced the sale of the houses other than the ones that you have mentioned?

A. Well, do you want the whole story on that, Mr. Wrixon?

Q. We would like to have it.

A. Along about the spring of 1945 after I was the sole remaining stockholder in Pacific Homes, it appeared that the war was about over and the im-

(Testimony of Ross H. Chamberlain.)

minent departure of all our tenants could be expected.

The telephone company, the Pacific Gas & Electric Co., and the Bank of America all made post-war surveys as to what the business situation was going to be sometime after the war, and their conclusions were so pessimistic that I began to wonder—especially when people move out of these houses and leave them in this terrible condition.

So along about May or June of 1945, it was getting pretty difficult to find new tenants. The lawns were growing up with weeds. We had to provide someone to mow the lawns and we had to water them so that they wouldn't be lost, and also to keep [87] the tract looking nice.

It got to be too expensive to, so I decided perhaps it would be better for the Corporation to dispose of these houses as they became vacant rather than continue to try to rent them all. Although we didn't keep any houses vacant. If somebody came along and wanted to rent a vacant house and didn't want to buy it, why, he was privileged to rent it, just so we would have someone in there that would pay the Bank every month instead of us—I mean, instead of the Corporation.

Q. Now, speaking with respect to the sales of houses which were made to persons other than those who held their purchase option, will you describe to the Court what was done by the Corporation in order to effect those sales?

A. Nothing much. The tract managers were in-

(Testimony of Ross H. Chamberlain.)

structed to sell the houses as they became vacant if possible and, if not, to rent them.

Q. Was any advertising campaign carried on?

A. No.

Q. Were any "For Sale" signs put on the property?

A. No. I might explain that if you would like to hear the explanation?

Q. Go ahead.

A. It is hard to remember back so many years. I can give a categorical denial about the advertising and signs because you never do that. It gives the tract a bad name. If you have [88] a lot of "For Sale" signs sticking up, why, it goes along with the philosophy of scarcity. When things are hard to get people want them more than they do when they are easy to get.

Q. Did the plaintiff put these houses in the hands—these houses which were sold to persons other than holders of purchase options, did you put any of those houses in the hands of real estate dealers for sale?

A. Well, as these people that held purchase option contracts took up their options, and as these tracts started to get—the part we operated became smaller and smaller, we finally dispensed with tract managers, and we wound up by having one fellow that looked after all the tracts of all the corporations.

At that time, why, he couldn't handle them all by himself, and there were no tract managers left

(Testimony of Ross H. Chamberlain.)

in some cases, so real estate agents that brought in customers that wanted to buy one of these houses were permitted to sell them and they were paid commissions. But there were very few of them. We did ourselves in almost every case.

Q. Well, now, Mr. Chamberlain, going back to this matter of intention, will you state to the Court what that intention was with respect to having houses built in the Homewood, in the Southwood and Shoreview Tracts?

Mr. Blackstone: At what time?

Mr. Wrixon: At the time the houses were built.

Mr. Blackstone: You are asking Mr. Chamberlain his own [89] intention?

Mr. Wrixon: Yes.

Mr. Blackstone: Very well.

The Witness: My intention as an individual is expressed in the intention of the Board of Directors, which is implemented in the act that we committed, which was the act of renting.

Q. And was that intention of yours and the Board of Directors' applicable to each of the three tracts, the Homewood, the Shoreview and the Southwood Tracts? A. That is right.

Mr. Wrixon: No further questions.

Cross-Examination

By Mr. Blackstone:

Q. Mr. Chamberlain, as I understand your testimony, we have in evidence here Exhibit 12 which is the application for priorities relating to 175 houses in the Homewood Tract. That application

(Testimony of Ross H. Chamberlain.)

states in effect that the 175 houses are being built for sale, and you have testified that you prepared that application yourself, is that correct?

A. Yes, I did.

Q. Then is it your testimony that after this application was made that you changed your mind as to what the houses were—what was to be done with those houses?

A. It wasn't actually a matter of changing my mind. As you see on the application, it was made to the Office of Production [90] Management, and that folded up about the middle of January, just two weeks after that application was made.

The story is this, if you would like to hear it.

Q. Well, my main question, Mr. Chamberlain, if your answer is directed to that—that would be, what I was asking for was, was there a change in what your company had in mind was to be done to those houses after the application was made which stated the houses were being built for sale?

A. The change was made at the request of the—that application was made at the request of the OPM, and the change was made at the request of WPB, who succeeded the OPM. You will notice all signatures on the last page there are repeated in the WPB signatures in the ensuing years. They were the same people, but different management and a different name.

Q. In other words, your testimony is that the officials of OPM requested you not to sell these houses, is that it?

(Testimony of Ross H. Chamberlain.)

A. No, the officials of the OPM requested us to make that application, which was made by me personally on December 31st and was taken by hand up to their office to get a stamp on December 31st.

I don't pretend to know the reason for the urgency, except that it appears it had something to do with the change in the administration of the Agency two weeks later when it became the WPB, and at that time the WPB requested that the [91] application be changed to "rent," and it so was and the houses were all rented. Things were pretty mixed up right at that juncture insofar as part of the war effort.

Q. Do you recall the specific circumstances under which you were requested not to sell the houses, but rent them?

A. Yes, I recall it distinctly. The request was made by a man named Jim Whiteside in the WPB, who told us now that there was a war on, the Government felt that the houses should be made available to any war worker regardless of whether he wanted to buy or not, and also that priority assistance would be given on a higher level for houses that were built for rent than for sale, and on the basis of his advice and his request, which I felt was a request that came from the Federal Government, the houses were built and were rented.

Q. Was there an objection on the part of the Government agency to selling the houses, however?

A. Yes, definitely.

Q. How can you explain, Mr. Chamberlain, the

(Testimony of Ross H. Chamberlain.)

fact that a majority of these houses are leased with an option to purchase? Was there an objection on the part of the Government agencies to those options to purchase?

A. The option to purchase was a free gift. We were entitled to give people an option to purchase if they wanted it. The thing we couldn't do was force them to purchase it. And as I explained in previous testimony, that wasn't the intention, [92] either, in the beginning. The intention was just to rent them, and we found it was more difficult to just rent them than it was to rent them and throw in the promise, "You can buy it later on if you want to."

Q. I find that a little hard to follow in relation to the Pacific Homes because, as I understand it, the first tract was constructed at Homewood, correct? A. Yes.

Q. And all those were initially rented with option to purchase, isn't that right? A. Yes.

Q. Where was this? A preceding property?

A. Didn't you understand my answer?

Q. No.

A. My answer was that we tried to rent them and couldn't then we changed the approach and said, "You can rent them and we will also let you buy them in 30 months, and the part of your rent will say that is profit—in other words, that \$10 between forty and fifty, the accumulation of that will be your down payment and you may, if you elect

(Testimony of Ross H. Chamberlain.)

to do so, use that as your paid-in equity in the house.”

Q. Do I understand correctly that on the Homewood Tract you first made attempt to rent those without an option to purchase? A. Yes.

Q. And you weren't able to rent a single house without an [93] option to purchase?

A. I suppose—I think that the guys down there couldn't rent any of them at all and the option to purchase contract was born at that time.

Q. Why, then, was there a difference between the Homewood Tract and Southwood and Shoreview that were built later? There you gave no option to purchase, correct?

A. Well, there is your answer. We didn't have to. The option to purchase was no advantage to us. There never would have been an option to purchase if I could have helped it.

Q. Would you explain that in a little more detail, Mr. Chamberlain?

A. Well, certainly. It is easy to explain. This option to purchase clouds the title to the house, and as long as an option to purchase is alive, why, the house doesn't exactly belong to you and doesn't exactly belong to the tenant. It belongs to the tenant if he wants it to, and you have to wait for him to make an election before you know where you stand. For instance, if we hadn't had these options to purchase we wouldn't have had to allow these people to abuse these houses so.

Q. I understand from your testimony, Mr.

(Testimony of Ross H. Chamberlain.)

Chamberlain, that it is your opinion that the Corporation's intention was simply to rent these houses? They had no intention to sell the houses? [94]

A. No, not at that time.

Q. Could you explain, then, why it is that all the tax returns that have been introduced in evidence and identified as tax returns of the Corporation show that the business of the corporation wasn't just the rental of houses to war workers, but the rental and sale of houses to war workers.

A. I think that designation is perfectly all right. I think it is a literal interpretation of the person preparing the returns as to the activities of the Corporation.

Q. You were engaged in making sales, then, as well as renting, is that what you mean?

A. Now, where there was a sale made, the company was in the position of having sold a house, and so I think that the return should say it covered not only renting, but also selling. Some of these sales were involuntary, as you know.

Q. Well, once you had given a purchase option in a lease to a tenant, then I take it the Corporation couldn't very well prevent the tenant from exercising the option to sell if he wanted to?

A. No.

Q. And that insofar as those leases are concerned, the corporation was, in effect, holding those houses for sale to the tenant if they desired to buy, is that not correct?

A. I think that is a fair statement. It is just

(Testimony of Ross H. Chamberlain.)

like a person in jail being a resident of the jail. It isn't because [95] he wants to. It is because he is in there and can't get out.

Q. You stated that after some experience it appeared renting these houses was not a profitable business, is that correct?

A. No, it didn't appear to be.

Q. I then take it that sometime in—you said the spring, was it, of 1945, you decided the houses should be sold as they became vacant, is that correct?

A. Yes. Well, it isn't exactly the case, either. We are talking about two different situations. In Pacific Homes the most vivid spot in my recollection is Southwood and seeing some weeds in the front yard, and that is where I decided to sell the houses as they became vacant.

Q. And when did you make that decision?

A. Oh, it was in June or July.

Q. Of what year?

A. Or May, 1945. I think it was right VE Day, which I believe was May 10th.

Q. Well, would you state that after that time, then, the Corporation or you had the intention that the Corporation should hold these houses for sale to customers as the houses became vacant?

A. No, they were held for rent; but the restriction I put on previously that they were not to be sold at all was lifted.

Q. Were there any instances that occurred that you can recall where persons came to you and asked

(Testimony of Ross H. Chamberlain.)

you to buy those [96] houses prior to that time and you refused to sell them?

A. In Sunnyvale, yes.

Q. In Sunnyvale? Which tract is that?

A. Sunnyvale had Homewood and Southwood.

Q. At Homewood, however, the tenants all had options to purchase—at least the first tenant, is that correct?

Q. So that there was nothing you could do about preventing sales to those tenants? A. No.

Q. In Southwood, you say there were instances you recall when persons wanted to purchase the house and you refused to sell it?

A. In the early part of the year.

Q. What year? A. 1945.

Q. As the one-year leases had expired?

A. Yes.

Q. Are you familiar with—Where are the resolutions of the Board of Directors?

According to the minutes of the meeting of the Board of Directors of Pacific Homes, Inc., on December 9, 1943, it is stated, and I quote:

“The Chairman then stated that the Corporation had sold and would in the future sell some of the homes owned by it, and that it would be advisable for [97] the directors to ratify the execution of all documents that had heretofore been executed by officers of the Corporation with respect to sales heretofore made, and to specifically authorize the execution of documents with respect to sales to be hereafter made.

(Testimony of Ross H. Chamberlain.)

“A discussion was had, and on motion duly made, seconded, and unanimously carried, the following resolution was adopted.”

I won't quote the resolution, but I just want to ask you if you recall the meeting of the Board of Directors? A. Yes.

Q. In December, 1943?

A. And I can inform you as to the discussion had if you would like to hear it.

Q. I am simply interested in finding out if at that time the Corporation did not, in effect, decide that it should sell these houses?

A. Some of those houses. Some of those houses were so beat up they weren't worth keeping, and we decided to sell the ones that had been abused the worst, put them into shape and sell them to people who would take them that way.

Q. Is it not true, Mr. Chamberlain, that the decision to sell these houses was made as a result of your determination that that would be the way to make the most profit out of these [98] houses?

A. Well, insofar as we weren't making any money out of rent of them at all, I would say that was a fair statement. Whether that was my conclusion or not at any given time, I can't say.

Q. After the decision was reached to sell these houses to persons as the houses became vacant, you have indicated that the Corporation did then sell to anyone that appeared that wanted to buy, is that correct? A. Correct.

Q. And you also testified it wasn't necessary to

(Testimony of Ross H. Chamberlain.)

employ any special selling whatever because your regular staff was able to make all the arrangements necessary for the sale of the houses, is that correct?

A. Well, it wasn't a staff exactly: It was this woman who was the tract manager that did it, or the man that was the tract manager as the case may be.

Q. If I understood you correctly, then, at the time that the decision was made that the houses should be sold as they became vacant, it thereafter was unnecessary to engage in any kind of activity, any kind of active sales campaign, because the houses more or less sold themselves? Would that be a fair statement?

A. I am trying to think of the implication of that. I think that is a fair statement. [99]

* * *

JAMES E. MOORE

a witness recalled on behalf of the plaintiff, having been previously duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

Further Direct Examination

By Mr. Wrixon:

Q. Mr. Moore, I will show you Plaintiff's Exhibit 10, being the folder relating to the Homewood Tract, and I will ask you to state to the Court whether you examined all the folders for the Homewood Tract houses? A. Yes.

(Testimony of James E. Moore.)

Q. And did you in all the folders which you examined find one or more leases corresponding in form to the leases which are shown in the folder introduced in evidence in this case for the Homewood Tract? [101] A. Yes.

Q. And did you examine folders in the Southwood Tract for each house in the Southwood Tract?

A. Yes.

Q. And did you find in each of the folders with respect to the Southwood Tract a lease corresponding in form to the lease which is in the folder which is in evidence for the Southwood Tract in this case?

A. Yes.

Q. Did you examine a folder for houses in the Shoreview Tract? A. Yes.

Q. And did you find in each folder of the Shoreview Tract a lease corresponding in form to the lease which is in evidence for the Shoreview Tract in this case?

A. Yes. It could be there are some exceptions to these three tracts, and I would like to see an exhibit that I prepared so that I could point out those exceptions.

Mr. Blackstone: Are the exceptions these things which are shown in Column 4?

A. I believe so. I would like to take a look and make sure of that.

Well, yes, it is in Column 4 on the Homewood Tract at Footnote "C" where there was no evidence of a signed lease agreement in that file folder. [102]

(Testimony of James E. Moore.)

On the Southwood Tract the exception would be Footnote "A" where the manager of the tract had been allowed to transfer his option from the Homewood Tract.

And on the Shoreview Tract in the Column headed up "Other" with parenthesis A, there were seven where I found no written lease agreement.

* * *

May the record show that at a special meeting of the Directors of Pacific Homes, Inc., held on the 18th day of April, 1942, pursuant to a written waiver of notice signed by all of the directors of the Corporation, the following resolution was adopted:

"Resolved: That Robert Wood and Louis Scheungnab be, and they hereby are elected to be Vice-Presidents of Pacific Homes, Inc.; and that David Bohannon be and hereby is instructed to notify and advise Wood and Scheungnab as to their duties in relation to the negotiations of rental contracts." [103]

With the Court's permission, also, I would like to make a further reference to a special meeting of the Board of Directors of Pacific Homes, Inc.

May the record show that a special meeting of the Directors of Pacific Homes, Inc., was held at the office of the Corporation on the 28th day of September, 1946, at 10 o'clock a.m. of that day, and at the said meeting the Board of Directors proceeded to consider the matter of winding up and dissolving the Corporation, and upon motion unanimously

carried, the resolution relating to dissolution and winding up of the Corporation was then adopted.

Further, with the Court's permission, I would like to read into the record the details concerning the option to purchase which was granted to the tenants in the Homewood Tract. Your Honor has been advised that options were granted, but if I may, I would like to read the form of the option into the record.

The Court: What is your thought? What is the purpose of this testimony? To prove what?

Mr. Wrixon: The purpose of it is merely to acquaint your Honor with the terms of the option agreement.

The Court: What benefit does that enter into a tax in this case?

Mr. Wrixon: The only purpose, your Honor, is to amplify the testimony that was given yesterday concerning the [104] necessity for giving these purchase options in order to fill the houses that were held for rental, and I was merely suggesting it might be in order to inform your Honor of the terms of the option.

The Court: I am trying to follow your testimony, but in what manner does that have to do with the tax in this case?

Mr. Wrixon: Well, so far as the plaintiff is concerned, it doesn't have anything directly to do with the imposition of tax. It is just one of the statements, one of the facts which are required to be presented in order to present the entire case.

We do not believe that, in and of itself, it has any direct bearing on the tax consequences.

The Court: Very well, proceed.

Mr. Blackstone: May I reply to that comment? The Government's position is that the giving of an option for purchase has a very definite bearing on the issue of whether this Corporation was holding these houses for sale. We have no objection, of course, to the plaintiff acquainting your Honor with the details of the option. There is no objection to his reading the option.

Mr. Wrixon: May the record show that I am reading from one of the documents contained in Plaintiff's Exhibit 10, being a lease dated June 15, 1943, to L. W. Ocken. I am reading the portion relating to the option: [105]

"During the continuance of this agreement, and while you are not in default, you shall have the option to purchase the property for the sum of \$4,000 as follows:

"A payment of \$400 plus interest thereon at the rate of 6 per cent per annum from the date of this letter until paid shall be made by you in cash to Pacific Homes, Inc., at the time you elect to purchase the property; and you shall then assume or renew the then unpaid balance of the FHA loan against the property in such manner as to relieve Pacific Homes, Inc., of any liability therefor.

"You shall also pay the cost of the title policy and the cost of executing and recording documents.

"Such cash payment to Pacific Homes, Inc., will be reduced at the time you elect to purchase the

property by the difference between, one, the total of all rent paid by you and, two, the total of all FHA payments made by Pacific Homes, Inc., on the loan covering the property from date hereof.

“The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement. [106]

“Additional provisions:

“1. The property covered by this agreement is described as follows:

“2. If the dwelling on the property is under construction at the time this agreement is executed, the rental shall commence on the date Pacific Homes, Inc., can deliver possession of the property.

“3. No alterations of any kind in the dwelling shall be made without the prior written consent of Pacific Homes, Inc.

“4. The renters shall pay for all utilities services furnished to the property.

“5. The renter shall keep the property in first class condition and shall pay for all repairs.

“6. The renter shall not have the right to sublet the property or to assign this agreement or any interest in the property without the prior written consent of Pacific Homes, Inc.

“7. The FHA payments referred to herein shall include all payments made on account of principal and interest, fire insurance, taxes, FHA mortgage insurance, and all other FHA charges.

“8. The option to purchase granted to the renter shall be conditioned upon the renter being acceptable to the FHA as borrowers in lieu of [107]

Pacific Homes, Inc., and shall be subject to any conditions imposed by the War Production Board.

“9. The option to purchase shall expire on the first to occur of the following:

“A. Surrender of possession by the renter, or

“B. The expiration of 30 months from the date,
or

“C. Default by the renter which remains unremedied for 10 days after notice given to the renters by mail addressed to No. (blank) Avenue, Sunnyvale, California.

“Pacific Homes shall have the right to inspect the homes at any time.

“11. The renters are required to give at least 15 days' notice before vacating, and are required to remove all rubbish from the premises.”

I would like to ask permission, your Honor, to read one further portion of the exhibit attached to the stipulation—Exhibit No. 1.

Your Honor will recall that the application for priorities in the Homewood case for the first 175 houses indicated it was an application for priorities to build houses for sale. It has been stipulated that after the application had been filed, that is, shortly before March 8, 1943, Pacific Homes, [108] Inc., addressed a letter to the Federal Housing Administration relating to said December 31st, 1941, application concerning the 175 houses. This is the letter, which I will now read.

The letter is undated, but it is stipulated it was written shortly prior to March 8, 1943.

“Mr. D. C. McGinnes, District Director,
“Federal Housing Administration,
“315 Montgomery Street,
“San Francisco, California.

“Re: Priorities in Case No. 77-121-000866 in
Serial No. 1731.

“Dear Mr. McGinnes:

“Number of units 175. Number of rooms, 5 (2 bedrooms). Total payment per month during option \$45.00. Agreed sales price 24 at \$4,100, 151 at \$4,000. Length of option, 30 months.

“The above application was filed under date of December 31, 1941.

“All of the above houses are completed and occupied on the rental-option plan. Although the original application was for the purpose of sale, we have proceeded on the rental-option basis and have given all occupants option to purchase. We now discover in our original application a sales price was set \$3,675. This obviously was an error as we did not vary from our original estimates [109] of cost and sales price. The price set forth in the option given to tenants is \$4,100 for 24 of the units and \$4,000 for the balance of 151 units. The FHA commitment on the 24 units is \$3,700 and on 151 units, \$3,600. The total monthly payment on all of the units is \$4,500 per month each.

“We will appreciate the approval of the sales price as originally intended as above set forth.

“Very truly yours, Pacific Homes, Inc.,

“D. D. BOHANNON,

“President.”

Mr. Wrixon: That is all, your Honor, on behalf of the plaintiff.

Mr. Blackstone: May it please the Court, the Government has already introduced in evidence three of the tax returns, and we would like to introduce in evidence as Defendant's Exhibit D a copy of the minutes of a meeting of the Board of Directors of Pacific Homes on December 9, 1943. That was read to Mr. Chamberlain yesterday, but I would like to have the minutes introduced as an exhibit.

Mr. Wrixon has agreed to make a copy available so we wouldn't have to introduce the entire volume, and if that would be agreeable we would supply the Clerk either today or tomorrow with a copy to be marked Exhibit D.

DEFENDANT'S EXHIBIT D

Extract From Minutes of Special Meeting of the
Directors of Pacific Homes, Inc., Held on December 9, 1943

The Chairman then stated that the corporation had sold and would in the future sell some of the homes owned by it, and that it would be advisable for the directors to ratify the execution of all documents that had heretofore been executed by the officers of this corporation with respect to sales here-

tofore made and to specifically authorize the execution of documents with respect to sales to be hereafter made. A discussion was had and, on motion duly made, seconded and unanimously carried, the following resolution was adopted:

Resolved, that the President or any Vice President of this corporation, together with the Secretary or any Assistant Secretary of this corporation, be and they hereby are authorized to execute in the name, for and on behalf and under the corporate seal of this corporation, all deeds, agreements intended to effect the release of this corporation from liability on FHA loans, and other documents, which may be necessary or desirable in connection with such sales as may hereafter be made of real property owned by this corporation.

Resolved, Further, that all deeds, agreements and other documents of the character referred to in the first paragraph of this resolution which have heretofore been executed in the name, and for and on behalf of this corporation, by its President or any Vice President, and its Secretary or any Assistant Secretary, be and the same are and each of them is hereby ratified and approved.

[Endorsed]: Filed December 14, 1954.

We have no other evidence, your Honor.

[Endorsed]: Filed April 15, 1955. [110]

PLAINTIFF'S EXHIBIT No. 12

[Plaintiff's Exhibit No. 12 is an application by plaintiff to the Office of Production Management, Division of Priorities, dated December 31, 1941, and numbered 77-121-000866, for a preference rating on material entering into the construction of new privately owned defense housing under preference Order P55, and is applicable to 175 of the 212 houses constructed by plaintiff at Homewood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

“4. New construction for sale (include only single-family properties for sale-detached, semi-detached, and row houses):

“(a) The number of dwelling units for sale and the proposed sales price, including land, buildings and improvements are:

“Number of dwelling units: 175.

“Sales price Per unit: at \$3,675.00.

“Number of Dwelling units: ——

“Sales price per unit: ——”]

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBIT No. 13

[Plaintiff's Exhibit No. 13 is an application by plaintiff to the Office of Production Management, Division of Priorities, dated April 6, 1942, and numbered 77-121-001571, for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55 and is applicable to 31 of the 212 houses constructed by plaintiff at Homewood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

“5. New construction for rent (includes single-family properties for rent, and row houses):

“(a) The number of dwelling units for sale and the proposed sales price, including land, buildings and improvements, are:

“Number of dwelling units: 31.

“Total monthly rent per unit: \$50.00.

“Number of dwelling units: ——

“Sales price per unit: ——”]

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBITS Nos. 14, 15, 16

[Plaintiff's Exhibits Nos. 14, 15, and 16 are applications by plaintiff to the Office of Production Management, Division of Priorities, dated May 28, 1943; September 9, 1943, and October 21, 1943, respectively, and numbered 111-00487, 99-121-00609 and 99-121-01049, respectively, for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55, and is applicable to the total of 63 houses constructed by plaintiff at Shoreview Tract. Each application contains a certificate by plaintiff that it proposes new construction as follows:

“The Undersigned Hereby Certifies and Agrees That for the Duration of the Emergency Declared to Exist by the President on September 8, 1939:

“1. I will hold for rent the following accommodations at rental per units or in excess of the monthly charges designated in this schedule, except as otherwise authorized by General Orders 60-2 and 60-3 of the National Housing Agency; and I will not include in the lease of said accommodations any option to purchase except in accordance with said gen-

eral orders. (List on any one line only accommodations having the same room count, basic type symbol and rental. Give the exact rent in each case, not a range of rents. For information necessary to complete this schedule, see instructions):”

The number of houses to be built under the three applications are:

Family Dwelling Units

No. of Units	No. of Rooms	Basic Type Symbol	Lot No.	Block No.	Monthly Rent Per Accommodation	Charge for Tenant Services	Shelter Rent
51	5½	L	.....	.....	\$50.00	.....	.....
9	5½	L	.....	.....	\$50.00	.....	.....
3	5½	L	.....	.....	\$50.00	.....	.....

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBIT No. 17

[Plaintiff's Exhibit No. 17 is an application by plaintiff to the Office of Production Management, Division of Priorities dated September 9, 1943, numbered 99-121-00563 for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55, and is applicable to the 72 houses constructed by plaintiff at Southwood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

Family Dwelling Units

No. of Units	No. of Rooms	Basic Type Symbol	Lot No.	Block No.	Monthly Rent Per Accommodation	Charge for Tenant Services	Shelter Rent
72	L	1 to 72, inc.	.....	\$50.00	.....	.....

[Endorsed]: Filed December 13, 1954.



Form 1120

Treasury Department
Internal Revenue Service

UNITED STATES

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN

For Calendar Year 1944

or fiscal year beginning JUL 1, 1944, and ending MAY 31, 1945

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

3622 99 CIFIC HOTEL, INC.

(Name)

554-786 KING & CHESTNUT STREETS,

(Street and number)

REDWOOD CITY, CALIFORNIA

(City or town, postal zone number)

CARNE

427795

Kind of business: Development of subdivision - renting

Selling homes to defense workers

Business group serial number (from Instruction N) 182

NORMAL-TAX NET INCOME COMPUTATION

Item and
Instruction No.

529028 GROSS INCOME

CLAIM REJECTED

1. Gross sales (where inventories are
an income-determining factor) \$

2. Less: Cost of goods sold. (From Schedule A)

3. Gross profit from sales

4. Gross receipts (where inventories are not an income-determining factor) \$ 169,276.57

Less: Cost of operations. (From Schedule B) 133,030.14

Gross profit where inventories are not an income-determining factor

Interest on loans, notes, mortgages, bonds, bank deposits, etc.

File
Code

565247

Serial
No.

410059

District

(Cashier's stamp)
REC'D WITH REMITTANCE

AUG 17 1945

COLL. INT. REV.
1st DIST. CAL

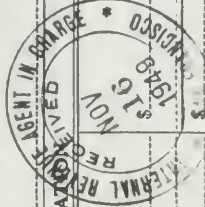
Cash

Check

M.O.

First Payment

\$



161

36,046.13

1 988102



36 COMPLETED RETURN

Page 1
1945

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN

For Calendar Year 1945

3187 for fiscal year beginning June 1, 1945, and ending May 31, 1946

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.
(Name)
Spring & Chestnut Sts., P.O. Box 1070
(Street and number)
Redwood City
(City or town, postal zone number)
California
(State)

Kind of business: Development of Subdivision, Renting &
Selling Homes

Business group serial number 182
(from instruction N)

Number of places
of business

One

Item and
Instruction No.

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor) Less: Returns and allowances \$

2. Less: Cost of goods sold (From Schedule A)

3. Gross profit from sales \$ 77,476.51

4. Gross receipts (where inventories are not an income-determining factor) Less: Cost of operations (From Schedule B) \$ 62,133.02

6. Gross profit where inventories are not an income-determining factor

7. Interest on loans notes mortgages bonds bank deposits, etc

File Code

Serial No. 410163

District

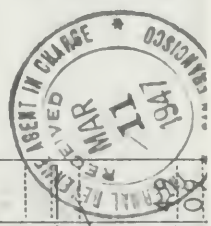
(Cashier's stamp)

Cash

Check

M. O.

First Payment



15,343
1,546

162



Form 1120
Treasury Department
Internal Revenue Service

FINAL RETURN
UNITED STATES

CORPORATION INCOME TAX RETURN

For Calendar Year 1946

Period of fiscal year beginning June 1, 1946, and ending May 31, 1947

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.
(Name)

650 MIDDLE AVE.
(Street and number)

MENLO PARK,
(City or town, post office number)

CALIFORNIA
(State)

Kind of business: Development of subdivision

Renting and selling homes

Business group serial number (from Instruction N) 182 Number of places of business One

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor) \$

2. Less: Cost of goods sold. (From Schedule A) \$

3. Gross profit from sales \$

4. Gross receipts (where inventories are not an income-determining factor) \$ 121,198.29

5. Less: Cost of operations. (From Schedule B) \$ 116,389.39

6. Gross profit where inventories are not an income-determining factor \$

7. Interest on loans, notes, mortgages, bonds, bank deposits, etc. \$

4,808.90
2,300.71

1946

File Code
Serial No. 410046

District

(Contributor's stamp)

Cash Check M. O.
First Payment

Trans. from 529024

9122
163

PLAINTIFF'S EXHIBIT NO. 21
Filed December 13, 1954.

Form 1121
Treasury Department
Internal Revenue Service

**UNITED STATES
CORPORATION EXCESS PROFITS TAX RETURN**

For Calendar Year 1945

or fiscal year beginning June 1, 1945, and ending May 31, 1946
PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.
(Name)

SPRING & CHESTNUT STS. - (P.O. BOX 1070)
(Street and number)

REDWOOD CITY, CALIFORNIA
(City or town, postal zone number) (State)

Business group serial number entered on page 1, Form 1120 182
EXCESS PROFITS TAX COMPUTATION

1. Excess profits net income (line 18, Schedule A) \$12,501.86
2. Specific exemption \$0.00
3. Excess profits credit \$0.00
4. Excess profits credit based on invested capital (line 46, Schedule C) \$0.00
5. Unused excess profits credit adjustment (line 47, Schedule C) \$0.00
6. Total of items 2 to 5 \$0.00

NON - ADJUSTMENT
Character Reduction
Total \$0.00

**COLUMN 1
INCOME CREDIT
METHOD**

**COLUMN 2
INVESTED CAPITAL
CREDIT METHOD**

\$ (28,069.91)
\$ 10,000.00
\$ 30,207.81
\$ 21,324.91
\$ 61,532.72

1945

File Code 565
Serial No. 9431213
District 1-10-10
(Cashier's stamp)

04
COLL. INT. REV.
1st DIST. CAL. M. O.
Cash Check
First payment

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD
ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and that they constitute the record on appeal herein as designated by the attorneys for the appellant:

Complaint to recover taxes paid.

Answer.

Requests for admissions under Rule 36.

Response of defendant U. S. of America to requests for admissions.

Stipulation with plaintiff's exhibits 1 to 7 attached.

Memorandum opinion.

Findings of fact and conclusions of law.

Judgment.

Notice of appeal.

Cost bond on appeal.

Designation of record on appeal.

Reporter's transcript of one volume of trial.

Plaintiff's Exhibits Nos. 8 to 22, inclusive.

Defendant's Exhibits Nos. A to D, inclusive.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 18th day of April, 1955.

[Seal]

C. W. CALBREATH,
Clerk.By /s/ MARY C. ROBB,
Deputy Clerk.

[Endorsed]: No. 14,732. United States Court of Appeals for the Ninth Circuit. Pacific Homes, Inc., a Corporation, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed April 19, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 14,732

PACIFIC HOMES, INC., a California Corporation,
tion,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS UPON WHICH
PLAINTIFF-APPELLANT, PACIFIC
HOMES, INC., A CORPORATION, INTENDS TO RELY

I.

The Court erred in finding as facts upon material issues in this case the following:

(a) that the houses in the Southwood Tract were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business, and

(b) that the houses in the Shoreview Tract here in issue were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business, and

(c) that the houses in the Homewood Tract, which were sold to persons without options to buy, were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business.

II.

That the Court erred in failing to find as facts upon material issues in this case the following:

(a) that the houses in the Southwood Tract were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that Plaintiff-Appellant decided to liquidate said tract.

(b) that the houses in the Shoreview Tract here in issue were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that Plaintiff-Appellant decided to liquidate said tract.

(c) that the houses in the Homewood Tract, which were sold to persons without option to buy, were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that the Plaintiff-Appellant decided to liquidate said tract.

III.

That the Court erred in failing to find as facts upon material issues in the case the following:

(a) That in early May, 1945, Plaintiff-Appellant decided to liquidate the Southwood Tract.

(b) that in early May, 1945, Plaintiff-Appellant decided to liquidate the Shoreview Tract here in issue.

(c) that in early May, 1945, Plaintiff-Appellant decided to liquidate the houses in the Homewood Tract not subject to an option to purchase on the part of the lessee.

IV.

That the Court erred in failing to find as facts upon material issues in the case, namely:

(a) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Southwood Tract with frequency or continuity.

(b) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Shoreview Tract here in issue with frequency or continuity.

(c) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Homewood Tract (other than those sold to option holders) with frequency or continuity.

V.

That the Court erred in failing to find as facts upon material issues in this case:

(a) That after Plaintiff-Appellant decided to liquidate the Southwood Tract, the method in which Plaintiff-Appellant sold houses in the Southwood Tract did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

(b) That after Plaintiff-Appellant decided to liquidate the Shoreview Tract here in issue, the method in which Plaintiff-Appellant sold houses in the Shoreview Tract did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such

sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

(c) That after Plaintiff-Appellant decided to liquidate the Homewood Tract, the method in which Plaintiff-Appellant sold houses in the Homewood Tract (other than to option holders) did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

VI.

That the Court erred in failing to find as facts upon material issues in the case the following:

(a) That Plaintiff-Appellant's sales of houses in the Southwood Tract were sales in the course of liquidation of its investment in that Tract.

(b) That Plaintiff-Appellant's sales of houses in the Shoreview Tract here in issue were sales in the course of liquidation of its investment in that Tract.

(c) That Plaintiff-Appellant's sales of houses in the Homewood Tract (other than to option holders) were sales in the course of liquidation of its investment in that Tract.

VII.

Finding number 6 of the Court's Findings of Fact is in error in stating that the Chairman of the Board of Directors of Plaintiff-Appellant expressed the intention of plaintiff to sell its houses on December 9, 1943, whereas, in fact the Chairman merely stated

that the corporation had sold and would in the future sell some of the homes owned by it. Said finding is further erroneous in failing to state (except with respect to homes in the Homewood Tract on which there was an option to sell) that plaintiff intended to rent all of its houses until it decided in early May, 1945, to liquidate the Tracts.

VIII.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Southwood Tract in the fiscal years 1945, 1946 and 1947 was taxable as ordinary income.

IX.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Shoreview Tract here in issue in the fiscal years 1945, 1946, and 1947 was taxable as ordinary income.

X.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Homewood Tract (other than sales to option holders) in the fiscal years 1945, 1946, and 1947 was taxable as ordinary income.

XI.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Southwood Tract held by Plaintiff-Appellant for more than six months, should be taxed as a long-term capital gain instead of as

ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XII.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Shoreview Tract held by Plaintiff-Appellant for more than six months, should be taxed as a long-term capital gain instead of as ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XIII.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Homewood Tract (except on sales to option holders) held by plaintiff-appellant for more than six months, should be taxed as a long-term capital gain instead of as ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XIV.

That the Court erred in failing to find as a fact that plaintiff-appellant's decision to liquidate the

tracts was caused by the adverse economic conditions incident to the end of World War II.

Dated, this 26th day of April, 1955.

/s/ L. W. WRIXON,

/s/ CARL. R. SCHULZ,

Attorneys for Appellant.

Receipt of Copy acknowledged.

[Endorsed]: Filed April 26, 1955.

[Title of Court of Appeals and Cause.]

STIPULATION THAT PORTIONS OF
EXHIBITS NEED NOT BE PRINTED

It is hereby stipulated by and between counsel for the respective parties in the above appeal that those portions of the exhibits not designated by either party to be included in the printed record on appeal may be printed by either party as an appendix to its brief, or in the alternative either party may furnish to the Court four typewritten copies of such portions.

Dated: April 28, 1955.

LLOYD H. BURKE,

United States Attorney ;

By /s/ GEORGE A. BLACKSTONE,
Assistant United States Attorney, Attorneys for
Appellee.

Dated: May 2, 1955.

/s/ L. W. WRIXON,

/s/ CARL R. SCHULZ,

Attorneys for Appellant.

[Endorsed]: Filed May 4, 1955.

No. 14,732

IN THE

United States Court of Appeals
For the Ninth Circuit

PACIFIC HOMES, INC., a corporation,	}
vs.	
UNITED STATES OF AMERICA,	
	<i>Appellant,</i>
	<i>Appellee.</i>

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

OPENING BRIEF FOR APPELLANT.

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FILED

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PAUL P. O'BRIEN, CLERK

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No. 14,732

IN THE

**United States Court of Appeals
For the Ninth Circuit**

PACIFIC HOMES, INC., a corporation,
Appellant,

VS.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

OPENING BRIEF FOR APPELLANT.

STATEMENT AS TO JURISDICTION.

This is an action by Appellant (plaintiff below), a California corporation, to recover from Appellee (defendant below), certain United States Income Taxes and United States Excess Profits Taxes which Appellant claims were erroneously and illegally collected by Appellee from Appellant (R. 3, 16, 17).

The District Court had jurisdiction under Title 28, U.S.C., Sec. 1340, 1346. Such jurisdiction is alleged in the complaint (R. 5, 8, 11, 14), and is admitted in the answer (R. 18, 19, 20, 21).

The complaint prayed for judgment against Appellee in the amount of \$141,041.48, with interest thereon (R. 16, 17). The case was tried to the Court without a jury (R. 49).

Judgment was rendered on February 16, 1955 that Appellant take nothing by its action and that its action and complaint be dismissed without costs (R. 50). The trial Court filed a Memorandum Opinion (R. 39).

Timely Notice of Appeal was filed on March 10, 1955 (R. 50, 51).

Hereinafter in this brief, Appellant will be sometimes referred to as plaintiff, because such reference will be more consistent with the record to which reference is being made. Correspondingly, Appellee in some cases, for convenience, may be referred to as defendant.

STATEMENT OF THE CASE.

The issue in this case involves the treatment, for federal income and excess profits tax purposes, of gains derived by plaintiff-appellant from the sale of single family dwelling houses constructed at defense housing projects known as Southwood, Shoreview and Homewood. All of the houses involved in this appeal were held more than six months prior to sale (R. 90, 91), and all had been leased prior to sale, either under simple leases or under leases with option to buy (Finding 5, R. 45). The leases with option to buy (356 in number, R. 75) were in all cases for a

term of 30 months and permitted, but did not compel, the tenant to purchase the house within that period. The simple leases contained no option to buy (R. 71). Of this latter type, 210 were for the term of 12 months, and 5 were month to month tenancies (R. 75).

The Court correctly states in its opinion:

“Plaintiff’s position is that the profits which resulted from their sales of defense housing were subject to the capital gains tax of 25% under Section 117(j) of the U. S. Internal Revenue Code. Defendant claims that the profits from the sales of defense housing should be taxed at ordinary income and excess profits tax rates in the same manner as if the houses constituted property held by plaintiff primarily for sale to customers in the ordinary course of its trade or business.” (R. 39.)

Full information respecting the number and types of leases appears in Appellant’s Exhibit 11 (R. 75). Full information as to the lease and sale history of the homes by months appears in Exhibits 5, 6 and 7 annexed to the Stipulation on file (R. 36, 37 and 38). Full information as to rents received (R. 33), profit from real property sales (R. 34), and investment in real property (R. 35) appears in Exhibits Nos. 2, 3 and 4 attached to the Stipulation (R. 33, 34 and 35).

This appeal involves the sufficiency of the evidence to support certain findings and the failure of the Court to find in accord with the evidence.

The Court made findings of fact which are numbered from 1 to 16, inclusive. For the Court’s con-

venience, we tabulate below the findings which we accept; those which we accept with a reservation, and those which form the basis for the claims in our Specification of Errors:

Findings which we accept: 1, 2, 4, 5, 9, 10, 11 and 13.

Accepted with a reservation: 7 and 15.

Claimed by Appellant to be Erroneous in whole or in part: 3, 6, 8, 12, 14 and 16.

The material which follows in this statement of the case has been taken from the above listed findings which we accept together with findings 7 and 15 which we accept with a reservation.

The action was brought pursuant to 28 U.S.C., Section 1346(a)(1) (R. 43) by plaintiff against the United States of America, for the refund of corporate Excess Profits Taxes, plus interest for the fiscal years ended May 31, 1945 and May 31, 1946; also for the refund of corporate income taxes for the fiscal years ended May 31, 1945 and May 31, 1947, with interest (Finding 1 rephrased, R. 43, 44).

By stipulation, the parties agreed that in the event the Court orders judgment in favor of appellant, and the parties are unable to agree upon the principal amount of the judgment and/or interest, each party should have the right to offer such additional evidence as may be pertinent to a determination of the amount of such judgment, and any interest thereon (Stipulation, R. 29).

Plaintiff was incorporated under the laws of the State of California on August 9, 1941, and was dis-

solved on May 31, 1947. Twenty-six shares of plaintiff's stock were originally issued to David D. Bohannon, who sold such shares to plaintiff's treasury on May 10, 1945. Twenty-four shares of plaintiff's stock were originally issued to Ross H. Chamberlain who, after May 10, 1945, was the sole stockholder of plaintiff corporation (Finding 2; R. 44).

On or about September 1, 1942, plaintiff completed the construction of 212 single-family dwelling houses in a subdivision known as "Homewood Tract". On or about January 1, 1944, plaintiff completed the construction of 72 single-family dwelling houses in a subdivision known as "Southwood Tract". On or about February 1, 1944, plaintiff completed the construction of 63 single-family dwelling houses in a subdivision known as "Shoreview Tract" (Finding 4, R. 44).

Seven of the houses in the Shoreview Tract were sold in the last three months of 1943 immediately upon construction. All 212 houses in the Homewood Tract were initially rented, after construction, to defense workers under leases containing options in the tenants to purchase the houses within 30 months. All of the houses in the Southwood Tract and the unsold houses in the Shoreview Tract were initially rented, after construction, without options in the lessees to buy the houses (Finding 5, R. 45).

Renting the Homewood Tract houses with purchase options in the tenants was an effective sales device in that it created a ready-made sales market for those houses. Such houses were necessarily held for sale

to tenants if they decided to exercise their options. Plaintiff voluntarily and without any compulsion from Federal Governmental agencies or other third parties granted the options to buy to the lessees of the Homewood Tract houses. Renting with option to buy was a method of doing business (Finding 7, R. 45).

(In conceding the correctness of this finding 7, we do so because, by its terms it is limited in its application to transactions at Homewood and refers to operations under lease-option arrangements. WE CONCEDE ON THIS APPEAL THAT SALES MADE BY PLAINTIFF AT HOMEWOOD BY THE EXERCISE OF A LEASE OPTION, ARE SALES TO CUSTOMERS PRIMARILY IN THE COURSE OF TRADE OR BUSINESS. THE DECISION OF THIS COURT IN ROLLINGWOOD v. C. I. R., 190 Fed. (2d) 263; CCA9, 1951, SO HELD. WE STATE MOST EARNESTLY HOWEVER, THAT EXCEPT IN THE SINGLE SITUATION WHERE THE SALE IS MADE BY THE EXERCISE OF A LEASE OPTION, THE REASONING OF THE ROLLINGWOOD CASE, WHEN APPLIED TO ALL THE FACTS OF OUR CASE, COMPELS A DECISION IN FAVOR OF APPELLANT.)

Commencing in June, 1944, and continuing through April, 1946, 137 houses in the Homewood Tract were sold to tenants exercising options in their leases to purchase. Commencing in April, 1945, and continuing through August, 1946, the remaining 69

houses in the Homewood Tract were sold to persons without options to buy (Finding 9, R. 46).

Commencing in April, 1945, and continuing through July, 1946, all 72 houses in the Southwood Tract were sold (Finding 10, R. 47).

Commencing in April, 1945, and continuing through June, 1946, all remaining 56 houses in the Shoreview Tract were sold (Finding 11, R. 47).

In addition to the sales of houses in Homewood, Southwood and Shoreview Tracts, plaintiff sold all of its houses in three other tracts, not here in issue, during the fiscal years ending May 31, 1946, and May 31, 1947, plaintiff having acquired such other tracts in its fiscal year ending May 31, 1946. Plaintiff went out of business and dissolved on May 31, 1947 (Finding 13, R. 47).

Because of the wartime and postwar demands for houses, plaintiff's houses were sold without the necessity of engaging in extensive advertising or sales campaigns. The houses in effect sold themselves. The absence of "For Sale" signs on the tracts had a sales motive and was a deliberate sales technique of plaintiff to give prospective costumers a sense of scarcity of available houses for sale and thereby make the house being sold seem more desirable. Most of the sales were made by plaintiff's salaried tract managers but where their efforts were not sufficient, sales were effected through real estate brokers on a commission basis (Finding 14, R. 47).

For reasons set forth hereafter, we take issue with the last sentence of Finding 14 reading:

“Plaintiff’s selling activities under the circumstances, together with the frequency and continuity of sales, were sufficient to constitute a trade or business of selling houses.” (Finding 14, R. 48).

The houses in the Homewood Tract which were sold to tenants pursuant to options to buy were held primarily for sale to customers in the ordinary course of plaintiff’s trade or business from the time the lease-option agreements were executed (Finding 15, R. 48).

In accepting this finding to be correct, we do so because it is limited to sales pursuant to options at Homewood Tract. This is consistent with the reservation made by us concerning Finding 7 (Ante p. 6).

SPECIFICATIONS OF ERRORS RELIED UPON.

When in this brief, reference is made to “houses here in issue”, it will refer to ALL sales of Southwood Tract, ALL sales at the Shoreview Tract (other than the 7 houses sold immediately on construction, Finding 5, R. 45) and sales of 55 houses at HOMEWOOD¹ on which the original lease had expired and

¹The “houses here in issue,” insofar as the Homewood Tract is concerned, include only the 55 houses listed in column 2 of appellant’s Exhibit No. 5 (App. p. iii). The sales of 141 houses at Homewood, appearing in column 1 of Exhibit No. 5 are excluded from consideration on this appeal because the Court found (Finding 7, R. 46, and Finding 15, R. 48) that the renting of such houses with an option to buy, was a method of doing business and that such houses, when sold, were held primarily

the houses were thereafter leased on simple leases without option to buy.

Appellant specifies the following listed errors:

1. The Court erred in finding and concluding without any supporting evidence, that the houses here in issue were ever held primarily for sale to customers in the ordinary course of appellant's trade or business. This specification of error embraces the subject matter contained in Findings 3, 8, 12, 14 and 16 (R. 44-48).

2. The Court erred in finding and concluding without any supporting evidence, that the Board of Directors of appellant on December 9, 1943, authorized the future sale of appellant's houses and that the Chairman of the Board of Directors of appellant expressed the intention of appellant to sell its houses; that thereafter appellant's intention was to pursue whichever activity, renting or selling, proved more profitable (see Finding 6, R. 45).

3. The Court erred in failing to find and conclude on the evidence, that the houses here in issue were held as an investment for the purpose of renting such houses to defense workers, and were so held at

for sale to customers in the ordinary course of appellant's trade or business. This finding is consistent with the decision of this Court in the case of *Rollingwood v. Commissioner of Int. Rev.*, 190 Fed. (2d) 263, CCA 9, 1951. The additional sales at Homewood Tract, 16 in number, shown in columns 3 and 4 of appellant's Exhibit No. 5, R. 36 (App. p. iii) are also excluded from consideration on this appeal because some of the facts concerning these transactions could not be ascertained with sufficient certainty to properly present the matter on this appeal.

the time appellant decided to liquidate said houses and in failing to find and conclude on the evidence that early in May, 1945, appellant decided to liquidate the houses here in issue.

4. The Court erred in failing to find and conclude on the evidence, that prior to early May, 1945, appellant did not sell any of the houses here in issue with frequency or continuity.

5. The Court erred in failing to find and conclude on the evidence, that after Appellant decided to liquidate the houses here in issue, the method by which Appellant sold said houses here in issue did not amount to going into the business of selling houses to customers in the regular course of trade or business, and that in making such sales, Appellant did not thereby enter the real estate business or make sales in the manner in which such a business is ordinarily conducted.

6. The Court erred in failing to find and conclude on the evidence, that appellant's decision to liquidate the houses here in issue was caused by misuse of the properties by tenants, and adverse economic conditions incident to the end of hostilities in Europe.

7. The Court erred in failing to find and conclude on the evidence, that appellant's sales of the houses here in issue were sales in the course of liquidation of its investment in said houses.

8. The Court erred in concluding as a matter of law, that the income received by appellant from the sale of the houses here in issue in the fiscal years

ended May 31, 1945, May 31, 1946, and May 31, 1947, was taxable as ordinary income.

9. The Court erred in failing to conclude as a matter of law, that the gain realized by appellant from the sale of the houses here in issue, held for more than six months, should be taxed as long-term capital gain instead of as ordinary income, and in failing to determine the amount to which appellant is entitled by way of judgment under paragraph 15 of the Stipulation in evidence (R. 29).

SUMMARY OF ARGUMENT.

The record will show that the houses here in issue were constructed with an original intent on the part of Appellant to hold them for rental. This original rental intent was recognized by the trial Court. In its opinion (R. 40) the Court stated that this original rental intent was later changed by "frequent sales".

The record shows that these "frequent sales" mentioned by the Court consisted of only 15 sales of houses here in issue from September, 1942, to April 30, 1945. Even these 15 sales include the sale of 7 houses at Shoreview immediately upon completion, because appellant considered an impending overpass construction to be detrimental (R. 133). Such 15 sales, when considered in connection with the number of houses in each Tract (212 in Homewood, 72 in Southwood, and 63 in Shoreview) cannot be consid-

ered sufficiently frequent to support the conclusion that Appellant's intent changed from a rental operation to that of engaging in the real estate business.

The record shows that a substantial rental operation was conducted by appellant continuously until on or about VE Day. The findings of the Court are consistent with this position, with the possible exception of Finding 6. As will be shown hereinafter, Finding 6 has no support in the record.

The decision by appellant to liquidate which was made on or about VE Day, resulted from a number of factors, such as the misuse of the properties by tenants and adverse economic conditions, such as vacancies. The almost nominal rate of return on appellant's investment to May 31, 1945 (2%-3% *before deducting any amounts for administrative expense*; R. 110-112) certainly supported this decision.

The record also shows that the method pursued by appellant in liquidating its rental operation involved none of the techniques ordinarily pursued by firms engaged in the business of selling real property. The sales were made without advertising or sales campaigns and without the use of "For Sale" signs.

The decisions to be cited hereinafter establish the right of a taxpayer to liquidate a housing project without losing the benefit of the capital gain treatment permitted by section 117(j) U. S. Internal Revenue Code. Appellant's liquidation procedure conformed with the requirements of the decisions authorizing capital gain treatment.

ARGUMENT.

1. THE COURT ERRED IN FINDING AND CONCLUDING WITHOUT ANY SUPPORTING EVIDENCE THAT THE HOUSES HERE IN ISSUE WERE EVER HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF APPELLANT'S TRADE OR BUSINESS AND THE COURT FURTHER ERRED IN FAILING TO FIND AND CONCLUDE ON THE EVIDENCE, THAT THE HOUSES HERE IN ISSUE WERE HELD AS AN INVESTMENT FOR PURPOSES OF RENTING SUCH HOUSES UNTIL SAID HOUSES WERE SOLD PURSUANT TO A DECISION TO LIQUIDATE THEM, WHICH LIQUIDATION DID NOT AMOUNT TO GOING INTO THE BUSINESS OF SELLING HOUSES TO CUSTOMERS IN THE REGULAR COURSE OF A TRADE OR BUSINESS.

In this case, which was tried to the Court without a jury, the Court made certain findings of fact (R. 43-48), and filed a Memorandum of Opinion (R. 39-43).

Stated briefly, the Court found that the houses here in issue were held by Appellant primarily for sale to customers in the ordinary course of appellant's trade or business (Findings 3, 6, 8, 12, 14 and 16; R. 44-48). The Court concluded from these findings that the income received by appellant from the sale of its houses was taxable as ordinary income and not as capital gain (R. 48).

The ultimate question is whether the Findings are supported in the record. *Pacific Portland Cement Co. v. Food Machinery & Chemical Corporation*, 178 Fed. (2d), 541, at page 548.

A finding is "clearly erroneous" under Rule 52(a) of the Federal Rules of Civil Procedure when, although there is evidence to support the Finding, the reviewing Court on the entire evidence is left with the

definite and firm conviction that a mistake has been committed. *United States v. U. S. Gypsum Co.*, 333 U. S. 364, 395 (1948).

A substantial portion of the evidence in this case is in the form of Exhibits, such as Exhibits 5, 6 and 7 to the Stipulation (R. 36-38), and Exhibit 11 (R. 75). These Exhibits show in detail the number of houses in the three tracts here involved, the sales by months of such houses, the leases of same, and other data. This evidence is uncontradicted. We are confident that when this Court examines these Exhibits and all of the other evidence, the conclusion will be inescapable that on the entire evidence, a mistake has been committed.

The statute involved is section 117(j) of the 1939 United States Internal Revenue Code. The pertinent portion of section 117(j) is quoted in the Appendix hereto (p. i). This section provides that gains from the sales of "Property used in the trade or business" shall be considered as gains from the sale of capital assets (Sec. 117(j)(2); App. p. i).

To qualify as "Property used in the trade or business" under the statute, the property may be "... real property used in the trade or business, held for more than 6 months". The houses here in issue meet these qualifications because:

(a) They constitute real property;

(b) They were all rented after construction (Finding 5; R. 45). In *McGah v. Commissioner*, 210 Fed. (2d) 769; C.C.A. 9, 1954, this Court held under similar circumstances that the petitioners

“used the houses by renting them”; (210 Fed. (2d) at page 770).

(c) They were all held more than six months (R. 90, 91).

Another test applied by the statute is that property which would otherwise qualify as “Property used in the trade or business” will not be so classified if it is “. . . property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . .” (Sec. 117(j)(1); App. p. i).

Appellant will show in the following pages of this brief that there is no evidence to support the finding that the houses here in issue were held by Appellant primarily for sale to customers in the ordinary course of its trade or business and that on the contrary when the Court considers the entire evidence, it will be apparent that Appellant held the houses here in issue for rental purposes until they were sold, and further, that such sales were conducted in a manner which did not constitute going into the real estate business or selling to customers in the regular course of a trade or business.

(a) Appellant’s Original Intent Was to Hold the Houses Here in Issue for Rental Purposes.

Shoreview Tract (63 houses) and Southwood Tract (72 houses) applications for priority assistance to build the homes specified they would be built for rent to defense workers and the houses were so rented (Stipulation, R. 25; Finding 5, R. 45).

In the Homewood Tract (212 houses) the first application for priority assistance filed on December 31,

1941, for 175 houses stated the houses would be built for sale (Stipulation, R. 25). However, at the request of the War Production Board (R. 139), the stated intention to sell was not carried out and, instead, all of the houses, when completed, were rented on the rental option plan; i.e., they were originally rented under a written lease giving the tenant a 30-month option to purchase (Stipulation, R. 25, 26, Finding 5, R. 45).

Mr. Chamberlain testified that the original intent of appellant in the construction of the Southwood Tract homes was to rent them (R. 123, 124). Mr. Chamberlain testified that Appellant's intent in the acquisition of houses in the Shoreview Tract was the same as he described in connection with Southwood (R. 126). Mr. Chamberlain also testified that the intention of the management and Board of Directors of Appellant was to construct houses for rent in Sunnyvale (Homewood Tract) rather than construct houses for sale (R. 128).

(b) The Houses Here in Issue Were in Fact Rented for Many Months in a Substantial Rental Operation.

Rental collections at the Homewood, Southwood and Shoreview Tracts were as follows during the five fiscal years of appellant's existence (R. 33):

FISCAL YEAR	HOMEWOOD	SOUTHWOOD	SHOREVIEW
May 31, 1943	\$ 83,480.81	None	None
May 31, 1944	109,011.97	\$11,961.32	\$14,590.08
May 31, 1945	94,085.78	42,945.16	32,645.63
May 31, 1946	28,585.50	26,430.60	18,460.41
May 31, 1947	627.80	(65.03)	115.00
TOTAL	462,875.03	81,272.05	65,811.12

Rental collections in the amount of \$462,875.03 from the three Tracts here involved show that the original stated intention to rent was carried out in an extensive rental operation.

Reference will be made hereinafter in this brief to a decision made by appellant on or about VE Day (May 10, 1945) to sell the houses as they became vacant (R. 143, 145). The foregoing tabulation of rental collections shows that in the fiscal year following such decision; that is, in the fiscal year ended May 31, 1946, rental collections from the three Tracts amounted to \$73,476.51. In other words, the rental operation of appellant was continued during the period of liquidation.

Significant, also, on the matter of appellant's intent to carry on a rental operation is the practice which was followed in leasing houses. The facts are set forth in appellant's Exhibit 11 (R. 75) which are as follows:

Data Re Number and Types of Leases

TRACT	TOTAL LEASES GIVEN	30 MONTH OPTION LEASES	NON-OPTION LEASES		
			TOTAL	MONTH TO MONTH	12 MONTHS
Homewood	419	356	63	5	58
Southwood	89	None	89	None	89
Shoreview	63	None	63	None	63

Comparing the number of houses located in each tract with the number of leases executed, we find:

(a) Homewood Tract. Here, a total of 419 leases were given. Only 212 houses were originally built in this Tract (Stip., R. 25). Some houses were leased 4 times (R. 76). After De-

cember 10, 1943 only non-option leases were executed, 58 of which were for 12 month terms (R. 75).

(b) Southwood Tract. Here a total of 89 leases were given, each for a 12 month term. Only 72 houses were originally built in this tract (Stip. R. 25).

(c) Shoreview Tract. Here a total of 63 leases were given—each for a 12 month term. 63 houses were originally built (R. 25), but only 56 houses were available for rent, after excluding the 7 houses which were sold immediately upon construction (Finding 5, R. 45) because of an impending overpass construction (R. 133).

Leasing defense houses for 12 month terms and without purchase options is wholly inconsistent with holding such houses primarily for sale in the ordinary course of a trade or business. A house subject to a 12 month lease term cannot be delivered to a purchaser (without the tenant's consent) and hence cannot be held by the owner primarily for sale to customers.

Successive leasing of houses as above indicated instead of selling the same upon the first vacancy evidences an intent to hold and use the houses in a rental operation.

(c) Appellant's Intent to Hold and Use the Houses Here in Issue in a Rental Operation Continued Until Appellant's Decision to Liquidate in Early May, 1945.

We have previously shown that the original intent of appellant in developing the war housing tracts at Homewood, Southwood and Shoreview was to rent the housing units, and that such intention was evidenced by an extensive rental operation which continued not only until VE Day (May 10, 1945), but also beyond that date.

The record shows that the intent to carry on an exclusively rental operation with respect to the houses here in issue continued until VE Day (May 10, 1945), on or about which date a change in policy occurred, and thereafter the houses here in issue were sold as they became vacant (R. 143-145).

Finding 16 (R. 48) recognizes that the houses here in issue were held for rental prior to and until the decision was made to sell the houses as they became vacant (the date of this decision is not stated in the finding but is fixed by the record (R. 143) as on or about VE Day, May 10, 1945). This finding declares that the houses here in issue

“ . . . were held primarily for sale to customers in the ordinary course of plaintiff's trade or business *from the time when the decision was made*, prior to the sales in question, *to sell all houses as they became vacant*, including those not subject to lease-option agreements”. (Italics supplied.)

Finding 16 (R. 48), in stating that the houses were held for sale to customers “ . . . *from the time when the decision was made . . .*” recognizes that *before*

that time, the houses here in issue were dedicated to a rental operation. We do not accept Finding 16 to the extent that it states that from the date of such decision, the houses here in issue “. . . were held primarily for sale to customers . . .”

Finding 8 (R. 46) reads in part:

“After several months of rental experience plaintiff found it to be unprofitable to continue to rent any of its houses. Plaintiff *thereupon* decided to hold all of its houses in the Homewood, Southwood and Shoreview Tracts primarily for sale to customers in the ordinary course of business in addition to those houses in the Homewood Tract which were already held by plaintiff primarily for sale under outstanding lease-option agreements. The tract managers were *then* instructed by plaintiff to sell the houses as they became vacant . . .” (Italics supplied.)

Neither finding 8 nor finding 16 specifies by particular date the time that the decision was made to sell the houses here in issue as they became vacant. However, finding 8 fixes the date it was decided to sell the houses as they became vacant when it declares that the tract managers were “then” instructed by plaintiff to sell the houses as they became vacant. The record fixes this date as VE Day (R. 135, 136).

Finding 8 (R. 46) and finding 16 (R. 48) thus support appellant’s position that until on or about VE Day, when the decision was made to sell the houses as they became vacant, all of the houses here in issue were used in a rental operation.

Except for an immaterial difference of a few days, the conclusion that the houses here in issue were

used in a rental operation until on or about VE Day (May 10, 1945) is consistent with and supported by findings 9, 10 and 11 (R. 46, 47). Findings 9, 10 and 11 declare that "Commencing in April, 1945" the remaining 69 houses in Homewood Tract (only 55 of which are here in issue); all 72 houses in the Southwood Tract, and all remaining 56 houses in the Shoreview Tract were sold.

Thus, the evidence and the findings support Appellant's showing that it intended to and did hold and use the houses here in issue in a rental operation until the decision to liquidate was made. The only difference—which is not material—is that some of the findings refer to the sales "Commencing in April, 1945" whereas the evidence shows that the actual decision to liquidate was made on or about VE Day (May 10, 1945).

This leads to the next questions, namely, the circumstances which prompted appellant's decision to liquidate and the method by which appellant sold the houses. These questions will now be considered.

(d) Appellant's Decision to Liquidate in Early May, 1945 Resulted From a Combination of Factors, to-wit, Misuse of the Properties by Tenants, and Adverse Economic Conditions Incident to the End of Hostilities in Europe.

The testimony of Mr. Chamberlain shows that it was not until VE Day (May 10, 1945) that appellant reached a decision to sell the houses to persons as the houses became vacant (R. 143, 145). The record shows that the decision to liquidate appellant's investment in the Homewood, Southwood and Shoreview Tracts

was the result of a combination of factors which may be summarized as follows:

1. The Misuse of the Properties by Tenants.

The uncontradicted testimony of Mr. Chamberlain was that the tenants gave the houses terrible treatment in many cases. In some instances the tenants would leave and take everything they could unscrew; that "It was awfully expensive" (R. 133, 134). Mr. Chamberlain testified that he felt appellant was morally bound to put the house in as nearly the same condition for the next person as the first one, which meant that appellant had to repaint and fix them all up, and it ran into a lot of money; that in the big tracts there were service departments that did not do anything but go around fixing up after these withdrawals (R. 133, 134).

2. Adverse Economic Conditions Incident to the End of Hostilities in Europe.

The uncontradicted testimony of Mr. Chamberlain (R. 134, 135) was that in about the spring of 1945 it appeared that the war was about over and the imminent departure of all of appellant's tenants could be expected. (The houses were single family defense housing dwellings, constructed in critical war effort areas. Stipulation, Pars. 6 and 11; R. 25, 28.)

Mr. Chamberlain stated that the Telephone company, Pacific Gas & Electric Company, and Bank of America made post war surveys as to what the business situation was going to be some time after the war, and their conclusions were so pessimistic that he began to wonder, specially when people moved out

of appellant's houses and left them in a terrible condition; further, that along about May or June of 1945, it was getting pretty difficult to find new tenants. Mr. Chamberlain further testified that the lawns were growing up with weeds; that appellant had to provide someone to mow the lawns and water them, so that they wouldn't be lost and in order to keep the tract looking nice (R. 135).

Mr. Chamberlain further testified:

“It got to be too expensive to, so I decided perhaps it would be better for the Corporation to dispose of these houses as they became vacant rather than continue to try to rent them all. Although we didn't keep any houses vacant. If somebody came along and wanted to rent a vacant house and didn't want to buy it, why, he was privileged to rent it, just so we would have someone in there that would pay the Bank every month instead of us—I mean, instead of the Corporation.” (R. 135.)

On the question of appellant's obligation to make monthly payments to the Bank on each house, it should be noted that each of the houses owned by appellant was subject to a separate construction loan, and a separate promissory note and deed of trust was executed by appellant for each such loan (Stipulation, paragraph 13, R. 28). Mr. Chamberlain's uncontradicted testimony is that a lot of appellant's houses became vacant in the spring of 1945 (R. 133).

The actual and potential vacancies are an important factor in determining whether *any* rental operation shall continue, but in appellant's case the actual and

potential vacancies assumed a position of critical importance, because they resulted not only in a loss of revenue, but also required appellant to obtain from other sources the funds necessary to make the monthly loan payments to the lending institution.

In summary, it can be said that the decision made at or about VE Day (May 10, 1945), to liquidate was a decision induced by economic factors over which appellant had no control, which economic factors were just as compelling as the pressure applied by the Central Bank in the case of *McGah v. C. I. R.*, 210 Fed. (2d) 769; CCA 9, 1954. Appellant is not required to wait until vacancies, misuse of premises, etc., *force* the lending institution to demand a sale of the premises in order to establish in appellant a right to capital gain treatment. On the contrary, to appellant's credit, appellant recognized the economic pressure and made the decision to liquidate at the time and in a manner which rendered it unnecessary for the lending institution to apply direct pressure to force sales of the houses as in *McGah v. C. I. R.*, 210 Fed. (2d) 769, CCA 9, 1954. This procedure should not deprive appellant of the right to capital gain treatment.

(e) Appellant's Sales of Houses Here in Issue Were Not Frequent and/or Continuous Prior to Early May, 1945, the Date of Appellant's Decision to Liquidate.

In the case of *Rollingwood v. Commissioner*, 190 Fed. (2d) 263, CCA 9, 1951, the frequency and continuity of sales were considered potent factors in determining the intent of the taxpayer. The Court there had the following to say in applying this fre-

quency and continuity test to the facts of the *Rollingwood* case:

“... In the instant case we have frequent and periodic sales commencing in the first fiscal year that the project was in existence and continuing throughout the entire period in question. We think the fact that 28 sales of houses were made in the first fiscal year and 178 sales in the second fiscal year of Rollingwood’s existence *to persons who did not have rental-option agreements or to whom Rollingwood was under no obligation to sell is very persuasive evidence of the purpose for which the houses were held*. Petitioners insist that the sales were passive in that there were no ‘for sale’ signs and no sales force. But the number of sales speak for themselves”. (190 Fed. (2d) 263, at page 267. Emphasis supplied.)

Applying the same test in our case, the results are as follows:

NUMBER OF HOUSES SOLD TO PERSONS TO WHOM APPELLANT
WAS UNDER NO OBLIGATION TO SELL
(EXCLUDES RENTAL-OPTION SALES)

FISCAL. DATES FROM COMPLETION OF TRACT

TRACT	FIRST FISCAL YEAR	SECOND FISCAL YEAR	THIRD FISCAL YEAR	FOURTH FISCAL YEAR	FIFTH FISCAL YEAR	TOTAL
Rollingwood	28	178	136	173	0	515
Homewood	0	2	8	52	9	71
Shoreview	7 ²	1	54	1	0	63
Southwood	0	8 ³	57	8	0	73
Total	7	11	119	61	9	207

²These seven houses at Shoreview were sold immediately upon construction, because appellant feared an impending overpass (R. 133).

³These 8 houses at Southwood were sold in the last 2 months of second fiscal year after being held for 15-16 months, and 1 was sold twice (App. p. iv).

These figures (to use the language of the Court in the *Rollingwood* case) speak for themselves. During the first two fiscal years the sales at Rollingwood were continuous and frequent. At Appellant's Tracts they were neither frequent nor continuous. At Rollingwood there were 206 houses sold in the first two fiscal years to persons who *did not have rental option agreements*. In our case 18 such sales in the first two fiscal years, scattered over three tracts, were neither frequent nor continuous.

Further evidence that appellant's sales of houses were neither frequent nor continuous is furnished by the Exhibits accompanying the Stipulation, to-wit:

(a) At Homewood Tract, out of 212 houses completed by September 1, 1942, 203 of these houses were still on hand two years later; (App. p. iii); and

(b) At Southwood Tract, *all* of the 72 houses completed by January 1, 1944 were still on hand 15 months later; (App. p. iv); and

(c) At Shoreview Tract (except for the seven houses explained in the footnote, ante, p. v), *all* of the 63 houses completed by February 1, 1944 were still on hand 14 months later (App. p. v).

The record thus shows that there was neither frequency nor continuity to appellant's sales prior to the date appellant decided to liquidate, namely, prior to VE Day, May 10, 1945. The frequency and continuity test cannot be applied after appellant's

decision to liquidate was made because frequent and continuous sales are a normal part of a liquidation process.

The significance of the frequency and continuity test in the *Rollingwood* case was that such test showed that *from the inception*, that is, *in the first two years* of Rollingwood's operations, there were frequent and continuous sales. The facts in our case are directly contrary in that, excluding lease option sales, there were only 18 sales of houses in the first two years including the 7 houses sold at Shoreview because of an impending overpass. The decision in the *Rollingwood* case cannot apply to appellant because of the basic factual differences in the number, type and times of sales of the houses involved.*

In our case, excluding lease option sales, we have an uninterrupted and exclusively rental operation from completion of the Homewood Tract in September, 1942 (App. p. iii) until on or about May 10, 1945, with a gradually reduced rental operation thereafter, as liquidation commenced and continued. The situation in Rollingwood is directly contrary. In that case there was no continuous rental operation for many months, followed by a determination to liquidate. Instead, in the *Rollingwood* case frequent, continuous and unexplained sales were made *immediately* after the tracts were completed, and these sales continued throughout the entire period of the *claimed* rental operation.

*Gains from lease option sales are not in issue on this appeal.

(f) **The Method by Which Appellant Sold the Houses Here in Issue Did Not Amount to Entering the Real Estate Business or Making Sales in the Manner in Which Such Business Is Ordinarily Conducted.**

The authorities are clear as to the effect that a housing project may be liquidated without losing the benefits of the capital gain provisions contained in Sec. 117(j) of the U. S. Int. Rev. Code.

Robert W. Dillon v. Commissioner of Int. Rev.,
213 Fed. (2d) 218, CCA 8, 1954;

Victory Housing No. 2, Inc. v. Commissioner of Int. Rev., 205 Fed. (2d) 371, CCA 10, 1953;

Delsing v. United States, 186 Fed. (2d) 59, CCA 5, 1951;

Winnick v. Commissioner of Int. Rev., 199 Fed. (2d) 374, CCA 6, 1952;

Lucille McGah v. Commissioner of Int. Rev.,
210 Fed. (2d) 769, CCA 9, 1954;

Lobello v. Dunlap, 210 Fed. (2d) 465, CCA 5, 1954.

The authorities are equally clear to the effect that if the liquidation is conducted in such manner as to constitute an entry into the real estate business, the taxpayer will not be entitled to the capital gain treatment permitted by Sec. 117(j) of the U. S. Int. Rev. Code.

The Home Co. Inc. v. Commissioner of Int. Rev., 212 Fed. (2d) 637, CCA 10, 1954;

Rollingwood Corp. v. Commissioner of Int. Rev., 190 Fed. (2d) 263, CCA 9, 1952.

The decision as to whether capital gain treatment will be allowed in any particular case has been said to depend on the facts of each particular case. In the case of *Lobello v. Dunlap*, 210 Fed. (2d) 465, CCA 5, 1954, the Court said at page 468:

“The expression ‘property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business’ would appear to be as simple, explicit and easily understood as the customs of business would permit. It has, nevertheless, proved difficult of application, and has been the subject of repeated consideration by this Court. (Citing cases) The cases cited illustrate that no rigid rule or fixed formula will furnish an answer to the question. Among the helpful factors that will point the way are: continuity and frequency of sales and sales related activities as opposed to isolated transactions; the extent and substantiality of the transactions; the activity on the part of the taxpayer or those under his instructions in the form of advertising and improvements; the purpose for which the property was acquired; and all other considerations going to the ultimate question of whether at the time of sale the property was held by the taxpayer primarily for sale to customers and also for sale in the ordinary course of the taxpayer’s trade or business. Since the question is one of ultimate fact (citing cases), the judgment of the district court should be affirmed unless found to be clearly erroneous.”

In the *Lobello* case the Court affirmed the lower Court in part and reversed it in part, holding that as to one tract the property was entitled to capital

gain treatment and as to another tract, the property should not be entitled to capital gain treatment.

In the case of *Robert W. Dillon v. Commissioner*, supra, the decision was for the taxpayer, and allowed capital gain treatment of the gains derived from the defense housing liquidation. In the case of *The Home Co. Inc. v. Commissioner of Int. Rev.*, supra, the decision denied the taxpayer the right to capital gain treatment of the gains derived on the liquidation of defense housing project. In the *Dillon* case, the Court concluded that the taxpayer did not go into the real estate business in accomplishing the liquidation, whereas the Court in *The Home Co. Inc.* case was of the opinion that the taxpayer engaged in the real estate business when liquidating the defense housing project. Notwithstanding the contrary conclusion, the *Dillon* case approved the rule announced in the case of *The Home Co. Inc.* which was stated as follows:

“One may, of course, liquidate a capital asset. To do so it is necessary to sell. *The sale may be conducted in the most advantageous manner to the seller and he will not lose the benefits of the capital gain provision of the statute, unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted.* In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost.” 212 Fed. (2d) at page 641. (Emphasis supplied.)

In our case the Court found (Finding 14, R. 47, 48) the following facts concerning the method used by appellant in disposing of the houses here in issue:

“Because of the wartime and postwar demands for houses, plaintiff’s houses were sold without the necessity of engaging in extensive advertising or sales campaigns. The houses in effect sold themselves. The absence of ‘For Sale’ signs on the tracts had a sales motive and was a deliberate sales technique of plaintiff to give prospective customers a sense of scarcity of available houses for sale and thereby make the house being sold seem more desirable. Most of the sales were made by plaintiff’s salaried tract managers but where their efforts were not sufficient, sales were effected through real estate brokers on a commission basis. Plaintiff’s selling activities under the circumstances, together with the frequency and continuity of sales, were sufficient to constitute a trade or business of selling houses.”

Contrary to the conclusion reached by the Court in the above-numbered Finding 14, the procedure followed by appellant in disposing of its rental properties did not follow the pattern of advertising and other sales promotion techniques used by persons holding real estate primarily for sale to customers in the ordinary course of their trade or business. The procedure followed by appellant involved a gradual, passive liquidation of a substantial investment in rental properties, which for the reasons heretofore stated in this brief, appellant did not consider appropriate to continue to hold and operate.

Section 117(j) U. S. Internal Revenue Code (App. p. i) does not by its terms, or by any implication, require that capital gain treatment be restricted to persons who make only a limited number of sales in

a taxable period. Instead, under the rule as stated in the case of *Robert W. Dillon*, *supra*, the sales (in liquidation) may be conducted “. . . in the most advantageous manner to the seller . . .”

(g) The Court Erred in Finding and Concluding Without Any Supporting Evidence That the Board of Directors of Appellant on December 9, 1943 Authorized the Future Sale of Appellant's Houses and That the Chairman of the Board of Directors of Appellant Expressed the Intention of Appellant to Sell Its Houses and That Thereafter Appellant's Intention Was to Pursue Whichever Activity, Renting or Selling, Proved More Profitable.

Finding No. 6 made by the Court reads as follows:

“On December 9, 1943, the Board of Directors of plaintiff authorized the future sale of plaintiff's houses and ratified past sales. At that meeting the Chairman of the Board of Directors of plaintiff expressed the intention of plaintiff to sell its houses. Thereafter plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable.” (R. 45.)

The foregoing finding misstates the Board of Directors' resolution to which it refers. The Directors' resolution of December 9, 1943 is set forth in full at page 155 of the Record. Contrary to finding 6, the resolution does not “authorize” the future sale of plaintiff's houses. The resolution, instead, authorizes the execution of deeds “and other documents which *may* be necessary or desirable in connection with such sales as *may* hereafter be made of real property owned by this corporation” (emphasis supplied). Such language is consistent with, and required, be-

cause of sales theretofore made and thereafter to be made pursuant to then existing purchase option tenants. The resolution *does not*, as stated in the finding, *authorize* the future sale of houses.

Finding 6 is directly contrary to the evidence to the extent that it states that at the December 9, 1943 meeting the Chairman of the Board of Directors expressed the intention of plaintiff to sell its houses. The preamble to the resolution (and on which preamble the finding presumably relies), says merely that "The Chairman then stated that the corporation had sold and would in the future sell some of the homes owned by it . . ." This quoted language does not express an intention of the appellant to sell its houses. The statement was merely that the corporation would sell "some of the homes owned by it", which statement merely recognized the necessity of conveying some of appellant's houses pursuant to the outstanding purchase options, then held by some tenants.

The balance of finding 6 (R. 45) reading,

" . . . Thereafter, plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable",

has no support in the record, since the two premises on which it is based are unsupported by the resolution of December 9, 1943.

However, if this Court believes Finding 6 correctly states the effect of the December 9, 1943 resolution, then:

(a) Such finding is contradictory to and irreconcilable with Findings 8 and 15 which purport to fix a different date from which appellant held its houses for sale to customers. This would constitute a failure to conform with the rule stated in *McGah v. Commissioner*, 193 Fed. (2d) 662, CCA 9 (1952), where the Court remanded a similar case to the Tax Court and said at page 663:

“ . . . There was, however, no finding as to whether the 14 houses were so held prior to their sale, or as to *when* and how long, if at all, the 14 houses were so held prior to their sale. Such findings should be made.” (Emphasis supplied); and

(b) Contradictory and irreconcilable findings on matters material to a proper disposition of the case are obviously self-destructive, and the Appellate Court should reverse the judgment because such findings cannot disclose the basis for the trial Court's decision as required by Rule 52(a).

Maher v. Hendrickson, 188 Fed. (2d) 700, 702 (C.A. 7, 1951).

(h) **The Rules Stated by This Court in *McGah v. Commissioner*, 210 Fed. (2d) 769 (1954) Require a Decision in Favor of Appellant.**

(1) **Two Types of Property Sales.**

In our case we have gains from two types of house sales, namely:

(a) Sales in the Homewood Tract to tenants who held purchase options (which gains *are not* in issue on this appeal); and

(b) Other sales in Homewood and all sales in Southwood and Shoreview Tracts (which gains *are* in issue on this appeal except 7 houses sold prior to the tax years here involved).

This Court, in *McGah v. Commissioner of Internal Revenue*, *supra*, stated that

“Petitioners Lucille McGah . . . were at all pertinent times engaged in the trade or business of renting and selling houses in San Leandro, California . . .” (210 Fed. (2d) at page 770).

The fact that the petitioners in the *McGah* case were at the same time engaged in two businesses, namely, the business of “*renting and selling*” houses, did not prevent this Court from segregating the two and holding that the petitioners were entitled to capital gain treatment on the sale of 14 houses which had been “used” in their trade or business by renting same.

In *Lobello v. Dunlap*, 210 Fed. (2d) 465, CCA 5, 1954, the Court also decided that as to one tract the taxpayers were taxable at ordinary income tax rates on gains from sales, whereas, the gains on sales from another tract were treated as capital gains and taxed accordingly.

(2) Findings 8 and 16 (R. 46, 48), Do Not Conform With Rule 52(a) and the Decision in *McGah v. Commissioner*.

This Court, in *McGah v. Commissioner*, 193 Fed. (2d) 662, said at page 663:

“. . . There was, however, no finding as to whether the 14 houses were so held prior to their sale, or as to *when and how long*, if at all, the

14 houses were so held prior to their sale. Such findings should be made . . .” (emphasis supplied).

Findings 8 (R. 46) and 16 (R. 48) do not specify “when and how long” the houses here in issue were held primarily for sale to customers in the ordinary course of business. Findings 8 and 16 fail to find on a material issue and, therefore, do not conform with Rule 52(a) Federal Rules of Civil Procedure.

(3) **The Circumstances Surrounding Appellant’s Liquidation of the Houses Here in Issue Are Comparable With the Compulsion Under Which the 14 Houses Were Sold in the McGah Case.**

We have previously set forth in this brief how appellant’s decision in early May, 1945 to liquidate resulted from the misuse of the properties by tenants and adverse economic conditions incident to the end of hostilities in Europe (ante, pp. 22-24).

In *McGah v. Commissioner*, supra, this Court (210 Fed. (2d) at page 772) stated that it found no support for the conclusion that prior to the date the petitioners were pressed by the bank to sell some of the houses they had changed their admitted purpose of holding the properties for rent to holding them for sale. In our case we have shown that up to the time of the decision to sell the houses as they became vacant (on or about May 10, 1945) the houses had been held for rental (ante, pp. 19-21). Appellant’s decision to sell was induced by an external economic compulsion which differed merely in form, but not in effect, from that involved in *McGah v. Commissioner*, supra. The

decision in our case should be the same as in the *McGah* case.

2. CONCLUSION.

The trial Court erred in finding and concluding that the houses here in issue were ever held primarily for sale to customers, and erred in failing to hold that the sales of houses made by appellant constituted the liquidation of an investment to which the capital gain provisions of section 117(j) U.S. Internal Revenue Code are applicable. The trial Court, pursuant to paragraph 15 of the Stipulation (R. 29) should have directed that Appellant was entitled to capital gain treatment on the following houses sold by it:

- (a) 55 houses in the Homewood Tract (App. p. iii, column 2);
- (b) All of the houses in the Southwood Tract;
- (c) All of the houses in the Shoreview Tract, except the 7 houses sold immediately upon construction and prior to the tax years here involved.

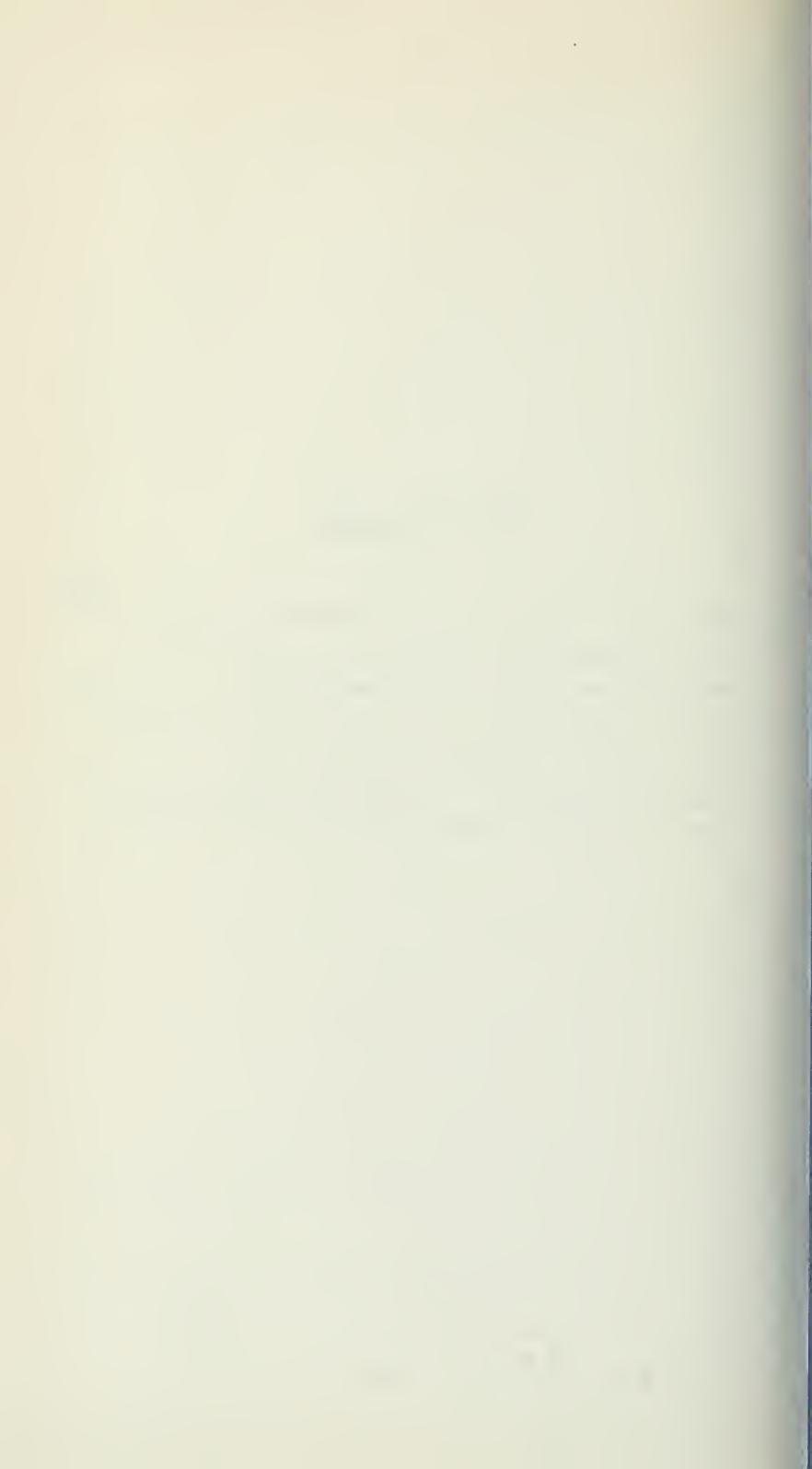
Dated, San Francisco, California,
August 26, 1955.

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(Appendix Follows.)

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Appendix.



Appendix

SECTION 117(j) UNITED STATES INTERNAL REVENUE CODE.

(j) Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.

“(1) Definition of property used in the trade or business.—For the purposes of this subsection, the term ‘property used in the trade or business’ means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (a)(1)(C). Such term also includes timber or coal with respect to which subsection (k)(1) or (2) is applicable and unharvested crops to which paragraph (3) is applicable. Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry.

“(2) GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of prop-

erty used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets . . .”

EXHIBIT No. 5 (R. 36)

Summary Showing Sales of Houses, All But One of Which (Footnote c) Were Originally Occupied by Tenants Under Leases With 30-Month Options to Purchase (Homewood Tract)

Month and Year	Col. 1 Sales to Tenant's Holding Purchase Options	Col. 2 Sales Made After Purchase Options Had Been Exercised After Tenant Had Been Occupied by Another Lessee or Simple Lease Without Purchase Option	Col. 3 Sales Made More Than Six Months After Last Purchase Option Agreement Was Executed, Not Included in Columns 1 or 2	Col. 4 All Other Sales	Col. 5 Number of Copies of First of Each Month	Col. 6 Number of Months Completed (Sept. 1749) from Date House to Date House Sold
1942						
June					50	
July					89	
August					156	
September					212	
October					212	
November					212	
December					212	
1943						
January					212	
February					212	
March					212	
April	1				212	7
May					211	
June	2				211	9
July					209	
August					209	
September					209	
October					209	
November	1				209	14
December				1(a)	208	15
1944						
January				1(a)	207	16
February					206	
March					206	
April					206	
May					206	
June	1				206	
July	1				205	21
August	1				204	22
September	1				203	23
October	9				202	24
November	9				193	25
December	8				184	26
1945						
January	8				176	28
February	12				168	29
March	19				156	30
April	17	3			137	31
May	7	3		1(b)	117	32
June	9			1(a)	115	33
July	7			1(a)	96	34
August	9	2	1	1(e)	88	35
September	4				75	36
October	2	1	1		71	37
November	5	3			67	38
December	2	2			59	39
1946						
January	1	5	1	1(a)	55	40
February	2	5	2		47	41
March	1	10	1	1(a)	38	42
April	2	5			25	43
May		7	1		18	44
June		5		1(b)	10	45
July					4	
August		4			4	47
September					0	
Totals	141	55	7	9		

(a) These houses were sold less than 30 months after the last purchase option agreement was executed.

(b) Unable to ascertain complete lease history. However, houses were completed and sold respectively June 1, 1932, May, 1945 and July, 1942—June, 1946, periods of 37 and 47 months. Original purchase option lease agreements were dated August, 1942, and September, 1942, respectively.

(c) This house does not show evidence of a signed lease agreement. However, it was completed in August, 1942, and sold in August, 1945, a period of 36 months. Construction commenced approximately January, 1942. Construction completed approximately September, 1942.

EXHIBIT No. 6 (R. 37)

Pacific Homes, Inc.—Southwood Tract

Summary Showing Sales of Houses at Southwood Tract—None of Which Were Ever Occupied by Tenants Under Leases With Options to Purchase

Month and Year	Sales to Non-Tenants	Sales to Tenants	Number of Houses on Hand at End of Each Month	Number of Months Sales Made (January 1, 1941) to Date House Sold
1944				
January			72	
February			72	
March			72	
April			72	
May			72	
June			72	
July			72	
August			72	
September			72	
October			72	
November			72	
December			72	
1945				
January			72	
February			72	
March			72	
April		2	72	15
May		1	70	16
June	5(a)	1	69	17
July			63	18
August	1		62	19
September	1		61	20
October	3		58	21
November	5	1(b)	55	22
December	1		49	23
1946				
January	2		48	24
February	3		46	25
March	7	7	43	26
April	7	3	29	27
May	12		19	28
June	4	3	7	29
July	1		0	30
Totals	<u>55</u>	<u>11</u>		
	<u>55</u>	<u>11</u>		

(a) One of these was sold to the manager of the tract who had been allowed to transfer his option from the Homewood tract.

(b) Sold twice.

Construction commenced approximately August, 1943.

Construction completed approximately January, 1944



EXHIBIT No. 7 (R. 38)

Pacific Homes, Inc.—Shoreview Tract Summary Showing Sales of Houses at Shoreview Tract—None of Which Were Ever Occupied by Tenants Under Leases With Options to Purchase

Month and Year	Sales to Mortgagees	Sales to Tenants	(a) Other	Number of Houses Completed First of Each Month	Number of Months from Date House Completed to January 1, 1946 to Date House Sold
1943					
October			1		
November			4		
December			2		
1944					
January				53	
February				56	
March				56	
April				56	
May				56	
June				56	
July				56	
August				56	
September				56	
October				56	
November				56	
December				56	
1945					
January				56	
February				56	
March				56	
April	1			56	14
May				55	
June	2			55	16
July				53	
August	5			53	18
September	1	1		48	19
October	2			46	20
November	5			44	21
December	1	5		39	22
1946					
January	3	1		33	23
February	3	7		29	24
March	10	2		19	25
April	2			7	26
May	3	1		5	27
June				1	28
July				0	
Totals	38	18	7		

(a) This column represents sales where no writ en lease agreements were located in the file for each house.

Construction commenced approximately July, 1943.

Construction completed approximately February, 1944.

[Endorsed]: Filed December 13, 1954.

No. 14,732

IN THE

**United States Court of Appeals
For the Ninth Circuit**

PACIFIC HOMES, INC., a corporation,
Appellant,

VS.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

BRIEF FOR THE APPELLEE.

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On Appeal from the Judgment of the United States District Court
for the Northern District of California.

BRIEF FOR THE APPELLEE.

OPINION BELOW.

The opinion of the District Court (R. 39-43) is reported at 129 F. Supp. 796.

JURISDICTION.

This is an appeal involving federal income and excess profits taxes for the fiscal years ending May 31, 1945, May 31, 1946, and May 31, 1947. (R. 43-44.) The taxes in dispute, which amounted to \$141,041.48, were paid on February 3, 1948. (R. 6-7, 9, 12-13, 15.) Claims for refund were filed on September 8, 1949

(R. 7, 9, 13, 16), and were rejected by notices dated March 21, 1950, May 15, 1950, and February 6, 1951 (R. 7-8, 10-11, 13, 16). Within the time provided in Section 3772 of the Internal Revenue Code of 1939, as amended, and on March 19, 1952, the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 3-17.) Jurisdiction was conferred on the District Court by 28 U.S.C., Sections 1340 and 1346. The judgment was entered on February 16, 1955. (R. 49-50.) Within sixty days and on March 10, 1955, a notice of appeal was filed. (R. 50-51.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED.

Whether the District Court was correct in holding that the houses involved were held primarily for sale to customers in the ordinary course of taxpayer's trade or business within the meaning of Section 117(a) and (j) of the Internal Revenue Code of 1939, as amended, and, accordingly, that the gain realized on their sale was subject to taxation as ordinary income.

STATUTE INVOLVED.

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, prof-

its, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) [As amended by Sec. 115(b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definitions*.—As used in this chapter—

(1) *Capital Assets*.—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for

depreciation provided in section 23(1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, *supra*.] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term “property used in the trade or business” means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

STATEMENT.

The facts as found by the District Court (R. 43-48) are summarized as follows:

The taxpayer, a California corporation, was organized on August 9, 1941, for the purpose of engaging in the business of developing real estate subdivisions and renting and selling houses primarily to defense workers. The authorized capital stock consisted of fifty shares, twenty-six being issued to David D. Bohannon and twenty-four to Ross H. Chamberlain. After May 10, 1945, Chamberlain was the sole stockholder. (R. 44.)

The first subdivision developed by the taxpayer was known as the Homewood Tract. Construction of 212 single-family dwellings on this tract was completed on or about September 1, 1942. Thereafter, taxpayer developed two additional subdivisions, completing the construction of 72 single-family dwellings in the Southwood Tract on or about January 1, 1944, and the construction of 63 single dwellings on the Shoreview Tract on or about February 1, 1944. (R. 44-45.)

When construction was completed in the Homewood Tract all 212 houses were rented to defense workers under leases containing options permitting the tenants to purchase the houses within thirty months. This sales device created a ready-made market for the sale of those houses. All of the houses in the Southwood Tract and 56 of the houses in the Shoreview Tract were initially rented without purchase options in the leases. Seven of the houses in the Shoreview Tract were sold immediately after construction. (R. 45.)

The renting of houses in the Homewood Tract with options to buy in the leases was an effective sales device and was a method of doing business followed by Western Homes, Inc., Rollingwood Corporation and Greenwood Corporation, three other organizations not in issue here, which were initially owned and managed by Chamberlain and Bohannon. Such houses were necessarily held for sale to tenants. The granting of such options was voluntary on the part of the taxpayer. (R. 45-46.)

In a resolution adopted on December 9, 1943, the taxpayer ratified past sales of houses and authorized future sales. (R. 45.)

During the period from June, 1944, through April, 1946, 137 tenants in the Homewood Tract purchased houses by exercising their options. Commencing in April, 1945, and continuing through August, 1946, the remaining 69 houses in this tract were sold to persons without options to buy. (R. 46-47.)

In the period from April, 1945, to August, 1946, all 72 houses in the Southwood Tract were sold and from April, 1945, until July, 1946, the remaining 56 houses in the Shoreview Tract were sold. (R. 47.)

Sales of houses in the three tracts in issue were made during each of the tax years in question and all houses were sold by the end of August, 1946. Additionally, the taxpayer acquired houses in three other tracts in its fiscal year ending May 31, 1946, and sold all such houses by the end of its fiscal year May 31, 1947. (R. 47.)

The taxpayer dissolved and went out of business on May 31, 1947. (R. 47.)

Taxpayer's houses sold themselves. Due to the wartime and postwar demands, the houses were sold without engaging in extensive advertising or sales campaigns. As a deliberate sales technique taxpayer did not place "For Sale" signs on the houses. This had a sales motive in that it gave prospective purchasers a sense of the scarcity of available houses and made taxpayer's houses seem more desirable. Salaried tract managers made most of the sales; however, where their sales efforts were insufficient, sales were made by real estate brokers on a commission basis. (R. 47-48.)

SUMMARY OF ARGUMENT.

The District Court determined that the houses in issue were held primarily for sale to customers in the ordinary course of taxpayer's trade or business.

This Court, as well as other Appellate Courts which have passed on the matter, has held that the issue is a factual one and that upon review the lower Court's decision will not be disturbed unless it is "clearly erroneous".

This review necessarily requires an examination of the entire record by the Appellate Court. In making such an examination it will be seen that there was ample evidence before the District Court to justify its ultimate findings, particularly in the light of the de-

cided cases by this Court and other Appellate Courts on the subject.

Taxpayer contends that it was engaged in a rental business and that the sales were made as a part of a plan to liquidate and dissolve the business. The evidence is inconsistent with this contention and shows, among other things, (1) a decision made by the taxpayer prior to the sales, which resulted in the houses being held for sale, (2) a method of doing business which automatically resulted in sales, (3) sales in all three years involved, (4) activity on the part of taxpayer's principal stockholders in similar undertakings which resulted in frequent and numerous sales of houses, (5) an announced intention to sell houses rather than rent them if this would result in a greater profit, (6) sales activity on the part of the employees of the taxpayer as real estate brokers, and (7) a decline in rental income coupled with a sharp rise in sales income.

The District Court exercised its function with care and its findings and judgment are supported fully by the record.

ARGUMENT.

THE DISTRICT COURT PROPERLY FOUND THAT DURING THE TAXABLE YEARS IN ISSUE THE PROPERTIES IN QUESTION WERE HELD BY THE TAXPAYER CORPORATION PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF ITS TRADE OR BUSINESS.

The single issue for determination here is whether the gain realized from the sale of the houses in ques-

tion is to be treated as ordinary income or is to be afforded treatment as a long-term capital gain.

Taxpayer's contention is that it was its intention at the time of construction to hold the houses for rent (Br. 15) and that this intention continued until the decision was made in May of 1945 to liquidate its assets and, therefore, the gain should be offered as capital gain treatment (Br. 19).

The Internal Revenue Code of 1939, Section 117 (a) (1), *supra*, defines "capital assets" as property held by the taxpayer, but excludes from this definition, among other things, "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The taxpayer concedes that the houses were used in a "trade or business." (Br. 14.)¹ Accordingly, taxpayer relies upon Section 117 (j), *supra*, which provides that the gain from the sale of property may be considered as a capital gain if the property comes within the definition in subparagraph (1), of—

real property used in the trade or business, held for more than 6 months, *which is not * * * held * * * primarily for sale to customers in the ordinary course of his trade or business. * * ** [Emphasis supplied.]

The Commissioner contends and the District Court found as a fact that (R. 48):

¹In fact, the taxpayer concedes that 164 out of the total of 347 houses were held primarily for *sale* to customers in the ordinary course of its trade or business. (Br. 6, 8.)

The houses * * * in issue were held primarily for sale to customers in the ordinary course of plaintiff's trade or business * * *.

This finding by the District Court is determinative of the issue and will be accepted if supported by the evidence. The question is one of fact and the lower Court's decision may not be set aside unless "clearly erroneous." Thus, in *Stockton Harbor Indus. Co. v. Commissioner*, 216 F. 2d 638, 650, this Court said:

As stated in the outset, the scope of our review is limited. * * * We cannot substitute our judgment as to facts for that of the Tax Court, and can only upset the findings if there is no substantial evidence to support them. What is and what is not trade or business and when property is or is not held for sale to customers are questions of fact.²

See also *Higgins v. Commissioner*, 312 U.S. 212, rehearing denied, 312 U.S. 714; *Galena Oaks Corp. v. Scofield*, 218 F. 2d 217 (C.A. 5th); *Home Co. v. Commissioner*, 212 F. 2d 637 (C.A. 10th); *Williamson v. Commissioner*, 201 F. 2d 564 (C.A. 4th); *Harriss v. Commissioner*, 143 F. 2d 279 (C.A. 2d); *Fackler v. Commissioner*, 133 F. 2d 509 (C.A. 6th).³

²While many of the cases cited arose in the Tax Court, the scope of review here, as provided in Rule 52(a), Federal Rules of Civil Procedure, is the same.

³This Court has fixed and upheld the basic proposition in an array of cases. *McGah v. Commissioner*, 210 F. 2d 769; *Jones v. Commissioner*, 209 F. 2d 415; *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263; *Rubino v. Commissioner*, 186 F. 2d 304, certiorari denied, 342 U.S. 814, etc.

No single criterion or fixed formula has been established for the determination of whether property is held primarily for sale to customers in the ordinary course of business and each case must rest upon its own peculiar set of facts. The test usually emphasized is the frequency and continuity of the transactions resulting in the conduct of a trade or business. *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263 (C.A. 9th); *Ehrman v. Commissioner*, 120 F. 2d 607 (C.A. 9th). The Courts have given recognition to certain other guides, but, as this Court said in the *Stockton Harbor Indus. Co. case, supra*, pp. 650-651:

* * * in the last analysis, each case must be determined upon its own specific facts, and none of these incidences are present in all cases. * * *

As will be demonstrated below, the District Court's findings were not only free from clear error, but were fully warranted by the evidence.

The taxpayer states that it was its original intention to construct rental units and that this intention carried over until May of 1945. (Br. 15, 19.) However, the Court found that after December 9, 1943, "plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable" (Finding 6, R. 45) and that "The houses * * * here in issue were held primarily for sale to customers in the ordinary course of plaintiff's trade or business from the time when the decision was made, *prior to the sales in question*, to sell all houses as they became vacant including those not then subject to lease-option agreements" (Finding 16, R. 48). [Emphasis supplied.]

These findings, together with the Court's opinion, make it clear that the date from which the houses were held for sale was on or about December 9, 1943. (R. 40-41.)

There is ample support in the record for these and the other findings. The Court had before it the original application of the taxpayer, dated December 31, 1941, to the F.H.A. for authority to develop the Homewood Tract, which stated that the houses were to be built for sale. (R. 25.) It is true that shortly before March 8, 1943, the taxpayer addressed a letter to F.H.A. advising that "Although the original application was for the purpose of sale, we proceeded on the rental option basis * * *." (R. 25-26, 30.) However, this does not change the purpose for which the houses were held, i.e., for sale. The principal purpose of that letter was, however, to advise of a change in the authorized purchase price from \$3,675 per house to \$4,100 for 24 units and \$4,000 for 151 units. (R. 30-31.)⁴

The taxpayer followed an established method of doing business (one followed in similar operations conducted by taxpayer's two stockholders) which called for the rental of all houses in the Homewood Tract with an option to purchase, and resulted automatically in sales when the options were exercised. (Br. 6.) See, also, Finding 7 (R. 46), which has been

⁴In *Delsing v. Commissioner*, 186 F. 2d 59 (C.A. 5th), the lower court relied upon the purpose stated in the application to construe the houses in issue. The Fifth Circuit reversed principally upon this ground. In the present case the application was only one item of evidence before the lower court which furnished a basis for its ultimate finding, *infra*.

accepted as to the part pertinent here by the taxpayer (Br. 6).⁵ It is submitted that all houses in the Homewood Tract were held for sale inasmuch as they were all initially rented with options to purchase. Light is shed on the taxpayer's intention with respect to all three tracts from Mr. Chamberlain's testimony (R. 130):

The Homewood Tract was the first tract and therefore could be considered to be the prototype of all of the other tracts.

Further, the taxpayer's accountant, who installed the system of accounts, made periodic checks and prepared the tax returns for the years in issue, stated in answer to a line of questioning upon cross-examination concerning the description of the kind of business entered on taxpayer's returns that the designation "Development of Subdivision, Renting and Selling Homes to Defense Workers" was an accurate description. (R. 102.) The tax returns for the fiscal years ending May 31, 1942, and May 31, 1943, stated that the kind of business was "Construction and Sale of Defense Homes" (R. 104, 106), while those for fiscal years ending May 31, 1944, 1945, 1946, and 1947 stated that the kind of business was "Renting and Selling Homes * * *" (R. 108, 161, 162, 163).

Additionally, and of major importance, is the extract from the minutes of a meeting of the directors on December 9, 1943, which shows (1) that the chair-

⁵The taxpayer in its brief has accepted the finding as to 157 units in the Homewood Tract admitting that they were held for sale from the time of completion. (Br. 6.)

man expressed the intention of taxpayer to sell its houses from time to time and advised the board to ratify prior sales and to authorize future sales, and (2) that the board took the recommended action. (R. 45, 154.) The cross-examination of Mr. Chamberlain in this regard is most revealing (R. 145):

Q. [by the Assistant United States Attorney]. Is it not true, Mr. Chamberlain, that the decision to sell these houses was made as a result of your determination that that would be the way to make the most profit out of these houses?

A. Well, insofar as we weren't making any money out of rent of them at all, I would say that was a fair statement. * * *

We submit that, from all the evidence, the lower Court was correct in its finding that after December 9, 1943, "plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable" (R. 45) and that this finding established the date from which the property was held for sale.⁶ However, taking the taxpayer's view of the record, which it is submitted is not borne out by the facts, it is seemingly

⁶This Court said in *Rollingwood Corp. v. Commissioner*, *supra* (p. 266):

Suppose the taxpayer in the instant case intended to rent the houses for as long as he was required to do so under existing regulations and then to sell them. Or suppose his intention was to pursue whichever of these activities proved to be the most profitable, that is, if the *rental market* were good he would continue to rent but if the *sales market* were high he would sell. In either of these suppositions we think it is fair to say that one of the essential purposes (in acquiring or holding the houses) is the purpose of sale. Under such circumstances, if the taxpayer does dispose of the houses by sale, is it within the legislative *purpose* to allow him to treat the proceeds of these sales as a capital gain? We think not.

clear that at least after the alleged decision to liquidate was made in May of 1945, the business continued as either a rental or selling operation depending upon which method of doing business was most profitable. (R. 135; Br. 23.)⁷

Courts have sometimes given consideration to the existence or absence of the advertising campaign carried on by the taxpayer. *Rollingwood v. Commissioner, supra*; *Home Co. v. Commissioner, supra*; *Lobello v. Dunlap*, 210 F. 2d 465 (C.A. 5th); *Snell v. Commissioner*, 97 F. 2d 891 (C.A. 5th). However, in the *Rollingwood* case, there was no advertising and no "For Sale" signs used, and this Court said (p. 267):

Petitioners insist that the sales were passive in that there were no "for sale" signs and no sales force. But the number of sales speak for themselves.

The taxpayer accepts the lower Court's finding that "The houses in effect sold themselves," and that "The absence of 'For Sale' signs on the tracts had a sales motive and was a deliberate sales technique * * *." (R. 47-48; Br. 7-8.) See also testimony of Mr. Chamberlain on page 146 of the Record. The frequency of sales indicates clearly that no advertising campaign was necessary or desirable.

⁷Mr. Chamberlain testified (R. 135):

Although we didn't keep any houses vacant. If somebody came along and wanted to rent a vacant house and didn't want to buy it, why, he was privileged to rent it, just so we would have someone in there that would pay the Bank * * *.

There were sales of houses in the tracts in issue in all three years involved. (R. 34.) Such sales were conducted by a ready-made sales force consisting of the tract managers (R. 135), and when sales lagged in a particular tract, the services of established real estate brokers was solicited (R. 79, 136-137). Taxpayer contends that the decision in *Rollingwood Corp. v. Commissioner, supra*, in which the frequency of sales was a factor, requires a decision in its favor. Taxpayer, of course, must exclude from consideration in making this contention the large number of houses sold under purchase options in the tracts in issue. (Br. 6.) In *Rollingwood*, one of the conditions imposed by the Government was that the houses to be constructed had to be rented initially with an option to purchase. (P. 264.) This provision was "an effective sales device" and resulted in many of the sales in the early years. However, in *Rollingwood*, two-thirds of the sales were made to non-tenants or persons not holding options to purchase (p. 266), and it cannot be said that the decision was based upon the fact that the leases contained options to purchase. As in *Rollingwood*, the number and frequency of sales in the instant case "speak for themselves."

Even though the sale of 157 houses in the Homewood Tract are not in issue, the taxpayer makes the point that 203 of them were still on hand two years after construction. (Br. 26.) A logical answer is that the houses in Homewood were all rented initially with 30-month options to purchase and, therefore, the tenants had two and one-half years within which to

exercise their options. With reference to the houses in the Southwood and Shoreview Tracts, attention is invited to the fact that they were all rented for a 12-month term and could not be sold until at least one year after the leases had expired. (Br. 17.) The first sales in the tracts were made from fourteen to fifteen months after *completion of construction*. (R. 37-38.) In both tracts this would have been in the Spring of 1945. Thus, the houses were sold when, or soon after, the leases expired, or, as Mr. Chamberlain testified (R. 133):

A lot of those houses became vacant toward—in 1945, in the spring, and the people that rented them or rented them with options to buy, as they became vacant, why, they were sold also.

It seems clear that sales were made as soon as possible under the leasing arrangements.

Further, the lower Court had support for its conclusion from the overall pattern of taxpayer's business as revealed by the record. It was found, and accepted by the taxpayer, that the "plaintiff was pursuing the same method of doing business as Western Homes, Inc., Rollingwood Corporation and Greenwood Corporation." (R. 46.) See also Exhibit 2. (R. 33.) The taxpayer's counsel in his opening statement advised the Court that in addition to the sale of houses in issue the taxpayer sold certain other property which was not held for six months at time of sale. (R. 54.) Certainly these houses were not constructed or purchased as a rental project. At least 40 houses were purchased and sold in another project after the al-

leged decision to liquidate taxpayer's assets because of the conclusion of the war in Europe, an activity which is inconsistent with the argument that the decision in May of 1945 to sell houses was forced upon taxpayer because of adverse economic conditions. (Br. 22-24.) Cf. *McGah v. Commissioner*, 210 F. 2d 769 (C.A. 9th). This Court considered the economic argument in *Palos Verdes Corp. v. United States*, 201 F. 2d 256, 259, and held that while the owner was forced to dispose of property because it "was eating its head off" through the expense of holding it, he nevertheless resorted to a method of disposal which submitted the property "to customers in the ordinary course of trade or business of real estate." See also *Home Co. v. Commissioner*, *supra*.

Finally, the decline in taxpayer's income from rental operations and the corresponding rise in sales income is convincing evidence of the activity engaged in and proof of the motive for "selling houses". *Winnick v. Commissioner*, 199 F. 2d 374 (C.A. 6th); *Snell v. Commissioner*, 97 F. 2d 891 (C.A. 5th).

Inasmuch as the issue here is a factual one and each case of this type must be decided upon its own peculiar set of facts, it is not believed to be necessary or helpful to consider further the cases cited by the taxpayer. It is sufficient to distinguish the case of *McGah v. Commissioner*, *supra*, which is relied upon heavily by the taxpayer. In that case, this Court found that the taxpayers, out of a large number of houses used in a rental business, were required to sell a small number of houses (14) in order to reduce their bank

indebtedness. Additional funds were desired from the bank for further construction of rental houses and the sale of some existing houses was required by the bank before it would make additional loans. The sales involved in the *McGah* case were not numerous and extended over only a portion of one year. The taxpayers there continued in the rental business after the year in question.

In contrast, there were over 300 sales extending over three years in the instant cases and activity continued until all houses were sold.

Certainly, the taxpayer here was not forced to sell its houses, as was the case in *McGah*. Indeed, after May, 1945, at least 40 additional houses were purchased and sold in other tracts.

CONCLUSION.

We submit that the District Court's findings are amply supported and that its judgment is correct and should be affirmed.

Respectfully submitted,

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October, 1955.

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Appeal from the United States District Court for the
Northern District of California,
Southern Division.

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IN THE

United States Court of Appeals

For the Ninth Circuit

PACIFIC HOMES, INC., a corporation,
Appellant,

VS.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

REPLY BRIEF FOR APPELLANT.

A. INTRODUCTORY STATEMENT.

Appellee's position, as set forth in its brief, does not sustain the judgment because it fails to follow, and is directly contradictory to, the undisputed testimony and the following exhibits which are stipulated by the parties to be correct.

<u>Exhibit No.</u>	<u>Subject</u>	
2	Rents received by appellant	(R. 33)
3	Profit from property sales	(R. 34)
5	Summary by months of sales at Homewood	(R. 36)
6	Summary by months of sales at Southwood	(R. 37)
7	Summary by months of sales at Shoreview	(R. 38)

Because of their direct application to the issues in this case, we have set forth exhibits 5, 6 and 7 in the appendix to our opening brief (App. pp. iii, iv, v). We respectfully ask this Court to study each position of each party in the light of those exhibits and the other uncontradicted evidence to be set forth herein. The parties have stipulated to the correctness of the above listed exhibits. Under the circumstances, this Court will draw its own inferences from undisputed facts. *Pacific Portland Cement Co. v. Food Machinery and Chemical Corporation*, 178 Fed. (2d) 541, 548; CA9; 1949; *McGah v. Commissioner*, 210 Fed. (2d) 769, 771; CA9; 1954.

We repeat at this point that the term "houses here in issue" (as in our Opening Brief p. 8), refers only to the 55 houses listed in Column 2 of Exhibit 5 (R. 36), all of the houses in the Southwood Tract (Exhibit 6, R. 37), and all of the houses in the Shoreview Tract (Exhibit 7, R. 38), except the 7 houses in Shoreview Tract which were sold immediately upon construction and prior to the tax years here involved.

B. ARGUMENT.

1. **THE FINDINGS DO NOT STATE WHEN AND HOW LONG ANY HOUSES HERE IN ISSUE WERE HELD FOR SALE PRIOR TO THEIR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF TRADE OR BUSINESS.**

In order to sustain the judgment, the findings of the trial Court are required to state "when and how long, if at all", the houses were held for sale prior

to their sale to customers in the ordinary course of trade or business. *McGah v. Commissioner*, 193 Fed. (2d) 662, 663; CA9; 1952. To satisfy the rule in the *McGah* case, the trial Court was required to find

(a) Whether the houses were held *primarily for sale to customers in the ordinary course of a trade or business*; and

(b) When and how long, if at all, the houses were so held.

Such findings were not made. If they had been made, they would have been without support in the record.

There are three findings in which the trial Court had a clear opportunity to find *when and how long, if at all*, the houses were held “*for sale to customers in the ordinary course of a trade or business*”.

Finding 6 (R. 45) could have declared, but does not declare that the date from which the houses here in issue were held for sale to customers in the ordinary course of trade or business was on or about December 9, 1943.

In Finding 16 (R. 48) the Court found sales to customers in the ordinary course of Appellant's trade or business, but failed to identify when and how long they were held, except to say that it was “prior to the sales in question”. Such a finding does not show when or how long they were so held, and was condemned by this Court in *McGah v. Commissioner*, 193 F. (2d) 662, 663; CA9; 1952.

Finding 8 (R. 46) refers to a decision by Appellant to hold all of its houses in Homewood, Southwood and Shoreview *for sale to customers in the ordinary course of trade or business*, but, again, the question of *when and how long they were so held* is avoided. The general reference to “after several months of rental experience” does not relate the decision to any known facts. But when the Court found that “the tract managers were *then* instructed to sell the houses as they became vacant”, the Record positively identifies that time as V-E Day, May 10, 1945 (R. 135, 136, 143). But if May 10, 1945 is the date from which Appellant is found to have held its houses for sale, such date nullifies Appellee’s argument made throughout its brief (pp. 12, 14) that Appellant held its houses for sale from December 9, 1943.

-
2. **NEITHER THE FINDINGS NOR THE EVIDENCE SUPPORTS APPELLEE’S CONTENTION THAT THE DATE FROM WHICH THE HOUSES HERE IN ISSUE WERE HELD FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF A TRADE OR BUSINESS WAS ON OR ABOUT DECEMBER 9, 1943.**

Recognizing (a) that the findings must fix the date when the houses were held for such sale and, (b), that the findings in our case do not specify such date, Appellee nevertheless asks this Court to accept December 9, 1943, as the date from which Appellant held the houses here in issue for sale to customers in the ordinary course of a trade or business. Appellee (Br. p. 11) refers to Findings 6 and 16 and, then, on page 12, states:

“These findings, together with the Court’s opinion, make it clear that the date from which the houses were held for sale was on or about December 9, 1943 (R. 40-41).”

Finding 6 (R. 45) does not so state (see ante, p. 3).

The Opinion (R. 40-41) upon which Appellee relies to support the quoted claim is based on the Directors’ resolution of December 9, 1943. We showed in our opening brief (p. 32) that the resolution did not state what Appellee contends is set forth therein. This point will also be covered more fully later in this brief.

Finding 16 (R. 48) relied upon by Appellee, by its terms contains NO reference to the date of December 9, 1943. It does, however, state that the houses here in issue were held primarily for sale “from the time when the decision was made, prior to the sales in question, to sell all houses as they became vacant . . .” The record shows unmistakably that the decision was made on *May 10, 1945*, not December 9, 1943, to sell houses as they became vacant. The testimony of Mr. Chamberlain on cross-examination was (R. 143):

Q. You stated that after some experience it appeared renting these houses was not a profitable business, is that correct?

A. No, it didn’t appear to be.

Q. I then take it that sometime in—you said the spring, was it, of 1945, you decided the houses should be sold as they became vacant, is that correct?

A. Yes. Well, it isn't exactly the case, either. We are talking about two different situations. In Pacific Homes the most vivid spot in my recollection is Southwood and seeing some weeds in the front yard, and that is where I decided to sell the houses as they became vacant.

Q. And when did you make that decision?

A. Oh, it was in June or July.

Q. Of what year?

A. Or May, 1945. I think it was right VE Day, which I believe was May 10th.

Q. Well, would you state that after that time, then, the Corporation or you had the intention that the Corporation should hold these houses for sale to customers as the houses became vacant?

A. No, they were held for rent; but the restriction I put on previously that they were not to be sold at all was lifted.

Summarizing, it is clear that none of the 3 sources referred to by Appellee (Br. p. 12) support its claim that the Findings declare that December 9, 1943 is the date from which the houses here in issue were held by Appellant primarily for sale to customers in the ordinary course of its trade or business.

Appellee, at pages 12 and 14 of its brief, urges this Court to construe the findings to mean that Appellant held the houses here in issue for sale to customers from December 9, 1943. The primary, if not the only, evidence to support such a construction of the findings are the minutes of the December 9, 1943 meeting of the Directors which are referred to on

page 13 of Appellee's brief as being "... of major importance . . ."

The language of the preamble and the resolution are set forth at pages 154-155 of the Record.

The directors' resolution of December 9, 1943, does not state specifically or indicate by inference an intention to change Appellant's business from a rental operation to holding its houses for sale to customers in the ordinary course of a trade or business.

The actual language of the resolution of December 9, 1943 shows that it is merely formal corporate action appropriate to a business which has had, or may have, *any* sales of real property, such as houses rented subject to purchase options and "Beat up" houses (R. 145). In our opening brief we pointed out that finding 6 (R. 45), misstated the resolution to which it refers (Br. pp. 32-33). Appellee's brief ignores this discrepancy because it has no answer. A reading of our opening brief (pp. 32, 33) in the light of the exhibits giving the rental history shows that no reasonable interpretation of the language used would sustain a contention that the resolution shows an intention to abandon the rental business in favor of holding houses primarily for sale to customers in the ordinary course of a trade or business. This is a matter on which the reviewing Court will draw its own inference. *Pacific Portland Cement Co. v. Food Machinery and Chemical Corporation*, 178 Fed. (2d) 541, 548; CA9; *McGah v. Commissioner*, 210 Fed. (2d) 769, 771; CA9; 1954.

When the subsequent record of renting without a single sale of one of the houses here in issue *for the next fifteen months* is considered (R. 36, 37 and 38), it becomes clear that there is no room for an inference that appellant, by the Director's resolution in December, 1943, thereby changed its entire business merely because it authorized corporate action as to SOME SALES.

With the proper effect given to the directors' resolution of December 9, 1943, appellee's reliance (Br. p. 11) on its construction of findings 6 and 16 is wholly discredited. This is of the utmost importance because unless finding 16 (R. 48) is aided by insertion of a definite date, December 9, 1943, the judgment cannot be sustained. The evidence will not permit such insertion of the date December 9, 1943, because the evidence shows:

(1) Appellant in December, 1943 was completing its Southwood and Shoreview Tracts in accord with its application for priorities to build defense houses for RENT (R. 158, 159):

(2) Appellant in fact rented these units after construction (Finding 5, R. 45);

(3) Appellant did not sell any of the houses in Southwood or *Shoreview Tracts until April, 1945—over 15 months after the date Appellee states Appellant commenced to hold its houses for sale to customers.

*Excluding the 7 houses sold because of an overpass.

(4) Appellant executed 63 non option leases, 58 of which were 12 month leases in the Homewood Tract, after December 10, 1943 (R. 75).

The uncontradicted evidence refutes Appellee's claim that Appellant after December 9, 1943 held its houses primarily for sale to customers and also effectively disposes of that portion of finding 6 (R. 45) which purports to hold that thereafter Appellant's intention was to pursue whichever activity, renting or selling, proved more profitable.

The fact is that with the houses in the Southwood and Shoreview Tracts leased under 12-month leases commencing in or shortly after December, 1943, *Appellant was in no position to hold any of such houses primarily for sale to customers in the ordinary course of a trade or business.* The fact is that Appellant did not hold such houses for sale at all, let alone hold them *primarily* for sale to customers in the ordinary course of its trade or business. Without the tenants' consents, the houses could not have been delivered to a prospective buyer while under 12-month lease commitments.

This condition is recognized and relied upon by Appellee to explain the *absence* of sales for the 15-month period between January 1, 1944, the approximate date of completion of construction of these houses, and early May, 1945, which is the date the decision to liquidate was made (Br. p. 17).

But this explanation by Appellee is wholly inconsistent with Appellee's claim in another portion of its

brief (p. 14) that *Appellant held its houses for sale from December 9, 1943*, and that its decision to so hold its houses was made at the meeting of the Board of Directors on that day.

3. THE ACCOUNTANT'S CHARACTERIZATION OF APPELLANT'S BUSINESS ON THE TAX RETURNS IS NOT INCONSISTENT WITH (a) A RENTAL OPERATION AND (b) SUBSEQUENT LIQUIDATION OF HOUSES HELD FOR RENTAL.

Appellee in its brief (p. 13) apparently believes that some inference favorable to Appellee should be drawn from the accountant's characterization of Appellant's business as that of "Development of Subdivision, Renting and Selling Homes to Defense Workers".

The fact is that Appellant (1) Rented houses and (2) Sold houses, for example, to tenant option holders and also houses which were "beat up" (R. 145). Hence the accountant's description was factually accurate.

The income tax numerical designation of Appellant's business by the accountants was classification No. "182". This numerical classification is described in the instructions for preparing corporation returns as applicable to "Owner-operators of improved property and Lessors of buildings" (R. 95, 96).

The accountants reported the gains from the sale of houses as long term or short term capital gains as the case might be. The accountants did not report such

gains as ordinary income as would be the case if the accountants believed that the gains from the sale of houses constituted gains from the sales of property held primarily for sale to customers in the ordinary course of its trade or business. Instead, the accountants reported on line 4 of the income tax returns for each year, the rentals received but not the gains from the sales of houses (R. 90-94; R. 161, 162, 163).

If the choice of words made by the accountants in characterizing the business of Appellant is considered significant in establishing the status of Appellant for tax purposes, (1) the conclusion of the accountants as to the form and method of reporting the gains on the sales of houses as gains from the sales of capital assets is much more significant because such determination involves a direct decision by the accountants on the matter here in issue and (2) the numerical classification of Appellant (No. 182) is of equal significance with the narrative, since No. 182 in the Corporate Income Tax instructions, signifies a corporation engaged in the business of acting as "Owner-operators of improved property and lessors of buildings" (R. 95, 96, 161, 162, 163).

4. THE REMAINING POINTS MADE IN THE SUMMARY OF ARGUMENT IN APPELLEE'S BRIEF DO NOT SUPPORT THE JUDGMENT.

We believe that all remaining contentions of Appellee are answered by the stipulated exhibits 5, 6 and 7 showing what actually happened with reference to

sales. We again urgently invite this Court's attention to those exhibits (R. 35, 36, 37).

Appellee (Br. p. 8) stresses the point that Appellant adopted a method of doing business which automatically resulted in sales. The above exhibits show that actual sales in each tract of houses here in issue were negligible prior to the decision to liquidate on VE Day, May 10, 1945. As to conditions *after* VE Day, the fact that the sales were automatic proves that Appellant did not enter into the real estate business.

Appellee (Br. p. 8) refers to activity on the part of taxpayer's principal stockholders in similar undertakings which resulted in frequent and numerous sales of houses. This point is based on Finding No. 7 (R. 45) of the trial Court, which relates explicitly and solely to the practice of renting with option to buy. By inference, then, it follows that at the Southwood and Shoreview Tracts, where there were no options to buy (Finding No. 5, R. 45), and at Homewood after the options terminated a different method of doing business was pursued.

Another point made by Appellee (Br. p. 8) is that Appellant announced its intention to sell its houses rather than to rent them if this would result in a greater profit. The fact is that Appellant could sell at a profit, where it did not appear able to rent at a profit (R. 143). Taking a profit or avoiding a loss is generally a major reason for liquidating an investment. As this Court said in *Ehrman v. C.I.R.*, 120 F. (2d) 607; C.A. 9, 1941:

" . . . We fail to see that the reasons behind a person's entering into a business—whether it is

to make money or whether it is to liquidate—should be determinative of the question of whether or not the gains resulting from sales are ordinary gains or capital gains . . .” (Page 610).

It is merely a matter of *how* the liquidation is carried out.

Appellee claims that there was sales activity on the part of the employes of the taxpayer *as real estate brokers* (Br. p. 8). We find nothing in the record to suggest that any employes of the taxpayer were real estate brokers, and believe that this is an unintentional error. To the contrary, the record shows that that the final cross-examination of Mr. Chamberlain on this point reads:

“Q. If I understood you correctly, then, at the time that the decision was made that the houses should be sold as they became vacant, it thereafter was unnecessary to engage in any kind of activity, any kind of active sales campaign, because the houses more or less sold themselves? Would that be a fair statement?

A. I am trying to think of the implication of that. I think that is a fair statement.” (R. 146).

Liquidation under such circumstances cannot possibly be considered such an entry into the real estate business as requires ordinary income treatment, *Robert W. Dillon v. Commissioner*, 213 Fed. (2d) 218; C.A., 8; 1954.

Appellee claims (Br. p. 8) that at some unstated time there was a decline in rental income, coupled with a sharp rise in sales income. Taking the two critical dates, December, 1943, and May, 1945, it is

interesting to note for the Southwood Tract the relation of income and rental (R. 33, 34) :

Fiscal Year	Net Rent Income	Sales Income
May 31, 1944 (Dec. 1943)	\$2,244.47	None
May 31, 1945 (May 10, 1945)	8,429.04	\$ 2,354.76
May 31, 1946 (first full year after May 10, 1945)	2,878.74	88,654.24

Instead of rent *declining* after the *supposed* decision to sell in December, 1943, it *increased*, while the sales income remained at nothing. The reduction of rent income coupled with a sharp rise in sales income occurred in the fiscal year following Appellant's decision to liquidate on VE Day, May 10, 1945.

The rent income and sales income at the Shoreview Tract (R. 33, 34) show the same pattern if we exclude the unusual and nonrecurring sales income of \$5,147.65 for the year ended May 31, 1944, which was due to the sale of 7 houses immediately upon construction, because of an impending overpass (R. 133).

As we have seen from the stipulated evidence in this case, all houses at Homewood were initially leased with 30-month options to purchase. Plaintiff's Exhibit No. 11 (R. 75) shows that although 419 leases were given on the 212 houses at Homewood, all *option* leases were given on or before December 10, 1943, and commencing December 21, 1943, only *non-option* leases were given. Because of the importance which Appellee attaches to the date of December 9, 1943, we cannot emphasize too strongly that it was only twelve days later that Appellant commenced giving 63 non-option leases at Homewood.

At page 26 of our opening brief, we pointed out that in September, 1944, two years after completion of the Homewood Tract, 203 houses were still on hand. This FACT was stipulated to and Appellee does not challenge it *as a fact*. Appellee does, however, say that a *logical* answer is that the tenants had two and one-half years to exercise their options (Br. p. 16). But this answer of Appellee can apply only to houses which were continuously under lease-option from September, 1942 to September, 1944, and cannot apply to the houses subject to *non-option* leases which are the houses here in issue.

The record shows that 356 *option* leases were given at Homewood on or before December 10, 1943. The record also shows that 63 *non-option* leases were given commencing December 21, 1943 (R. 75). Except in the case of the first non-option lease which was given on December 21, 1943 (R. 75), and one other non-option lease dated February 6, 1944 (R. 71), the record does not show affirmatively when the non-option leases were given commencing December 21, 1943. However, this information is shown by the worksheets of witness James E. Moore which were the basis upon which the summary of the number of option and non-option leases (R. 75) was developed. We believe that these worksheets should be before this Court, and propose to seek permission to place them in evidence.

If tabulated, they will show month by month the commencement dates of the rentals to non-optionees of the 55 houses at Homewood which are here in issue:

Month	Number of Houses Rented
December 1943	1
January, 1944	3
February, 1944	9
March, 1944	9
April, 1944	7
May, 1944	9
June, 1944	7
July, 1944	4
August, 1944	3
September, 1944	1
October, 1944	2
	—
Total	55
	==

Appellee also invites attention to the fact that the houses in the Southwood and Shoreview Tracts were all rented for a 12-month term, and could not be sold during that period. Again, we will request that the worksheets of witness James E. Moore showing when these houses were first leased be admitted in evidence. Photostats of these worksheets have been in the possession of Appellee since many months before the trial. They show the following:

SHOREVIEW	December, 1943	43
	January, 1944	10
	February, 1944	3
		—
	Total	56
		==
SOUTHWOOD	January, 1944	24
	February, 1944	19
	March, 1944	15
	April, 1944	14
		—
	Total	72
		==

C. CONCLUSION.

The uncontradicted evidence shows that, pursuant to applications for priority assistance, Appellant built defense houses for rent and actually rented the houses in a substantial rental operation to and including the decision made on or about VE Day, May 10, 1945, to liquidate the rental operation. The factors inducing the decision to liquidate are set forth in our opening brief (pages 21-24).

After the decision to liquidate, sales of houses were made without the efforts and tactics customary in a real estate operation. Instead, as set forth in Finding 14 (R. 47) the houses were sold without the necessity of engaging in extensive advertising or sales campaigns; the houses, in effect, sold themselves. We are unaware of any case in which the *absence* of a sales campaign and other aggressive selling tactics has been treated as indicating an entry into the trade or business of holding houses primarily for sale to customers. The absence of these factors obviously negatives such an entry into a trade or business.

The facts in our case, insofar as non-option sales are concerned, are clearly distinguishable from the facts in *Rollingwood Corp. v. Commissioner*, 190 Fed. (2d) 263; C.A. 9; 1951, relied upon by Appellant. In the *Rollingwood* case the sales of houses to non-tenants were immediate, frequent and continuous, in that in the first two years of Rollingwood's existence 203 houses were sold to non-tenants out of a total of 256 houses sold. The Court properly observed that such sales to non-tenants constituted "very persuasive evi-

dence of the purpose for which the houses were held". In the *Rollingwood* case there was no long period of rental operation culminating in a decision to liquidate, such as has been established in our case.

The element of frequency and continuity of sales was considered in our opening brief (page 24) and a statistical comparison was made of the number of non-option sales in our case and the *Rollingwood* case, particularly as such sales were related to each fiscal year. We also discussed in our opening brief the method by which Appellant sold the houses here in issue (page 28). Since the filing of our opening brief, the case of *Goldberg v. Commissioner*, 223 Fed. (2d) 709, C.A. 5; decided June 21, 1955, has come to our attention. This case deals with the problem of frequency and continuity of sales, and the question of whether sales of defense houses are to be considered as sales in liquidation of a rental investment, or whether they are to be treated as sales in the ordinary course of a trade or business. The Court used the following language in connection with these matters:

"The frequency and continuity of sales is also important. If a rental corporation's assets are sold in a single transaction to a single purchaser, it could not be reasonably contended that there was a sale to a customer in the regular course of business. But more often the owner sells his rental properties piecemeal to different individuals. How frequent the sales are depends on many circumstances; the extent to which the seller turns his talents to the promotion and solicitation of sales, the number of units in the rental project, and the

state of the market. Only the first of these circumstances has any rational connection with the question whether the owner has changed his business to selling, or is simply liquidating his business. Thus the frequency and continuity of sales factor is significant only so far as it reasonably justifies the conclusion that the owner somehow promoted the sales. The Courts do not deny capital gain benefits simply because a large number of sales are made in a short period; for if the owner has a large number of houses on a seller's market, it is quite possible that he may sell them continuously without any sales promotion or solicitation. . . ." (223 F. (2d) at page 712).

The facts in our case compel a decision for Appellant.

Dated, San Francisco, California,
October 24, 1955.

Respectfully submitted,

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CARL R. SCHULZ,

Attorneys for Appellant.



IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERT STRAND, Sheriff of San Diego County, State of
California,

Appellant,

vs.

WILLIAM SCHMITTROTH,

Appellee.

Appeal From the United States District Court for the
Southern District of California, Southern Division.

BRIEF OF AMICUS CURIAE.

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No. 14733

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERT STRAND, Sheriff of San Diego County, State of
California,

Appellant,

vs.

WILLIAM SCHMITTROTTH,

Appellee.

Appeal From the United States District Court for the
Southern District of California, Southern Division.

BRIEF OF AMICUS CURIAE.

Statement of Facts.

The petitioner is on probation to the United States Court for the Southern District of California for five years commencing January 17, 1955. [Clk. Tr. p. 22.] On the same day, while in custody of the United States District Court, appellee was seized and arrested by peace officers of the State of California and confined in the County Jail in the custody of San Diego. [Clk. Tr. p. 5.] Said officers of the State of California seized and confined appellee without first obtaining consent of the United States. [Clk. Tr. p. 5.]

Appellant's counsel stated in an affidavit filed in opposition to the Writ of Habeas Corpus that when petitioner was granted probation, "It is apparent that the charge pending against petitioner in San Diego County was not taken into consideration by the Court." [Clk. Tr. p. 16.] No consent to prosecute or incarcerate petitioner was ever obtained from the United States by the State of California. [Clk. Tr. pp. 22-23.] The United States District Court found that no consent had been given by the United States to the State of California to prosecute or incarcerate the federal probationer. [Clk. Tr. p. 5.]

On February 10, 1955, appellee filed his petition for Writ of Habeas Corpus [Clk. Tr. p. 11] alleging that he was unjustly and unlawfully detained by the Sheriff of San Diego County. [Clk. Tr. p. 3.] The petition also alleged that the petitioner pleaded guilty to the offense charged and was placed on five years probation as above alleged. [Clk. Tr. p. 4.] This allegation is admitted. [Clk. Tr. p. 13.]

On February 10, 1955, the Honorable Peirson M. Hall, United States District Judge for the Southern District of California, issued an Order to Show Cause returnable February 17, 1955, and directed the Sheriff of San Diego County to appear in the Federal Court to show cause why the petition should not be granted. [Clk. Tr. p. 12.]

Appellant filed an answer and therein affirmatively alleged, "that detention of the federal prisoner who is subject to the custody of the Federal Court by the State official is not illegal *until such time as the Federal Court*

shall refuse permission for such detention.” (Italics ours.) [Clk. Tr. p. 13.]

On February 17, 1955, the Federal District Court, the Honorable Peirson M. Hall, United States District Judge presiding heard appellant’s petition for the writ and ordered him discharged forthwith. [Clk. Tr. p. 17.]

At the hearing of the appellee’s Petition for Writ of Habeas Corpus, the Court stated with regard to the right of appellee to petition for habeas corpus in the situation in which the Federal Court had not consented to jurisdiction by the State Courts as follows:

“But nevertheless if we have not consented it seems to me that it is his liberty that is involved and he has the right to bring the petition.”

To which counsel for appellant replied:

“I agree with your thoughts. I think that those cases mean and what I have come in my study of them, I have come to this conclusion that when they say the defendant cannot raise the question, they mean by that that he cannot raise the question in the second sovereignty.

The Court: No, he cannot raise it in the State.

Mr. Brown: In the State right now. In other words, he raised it in the Municipal Court the other day by objecting to the jurisdiction of the Court and his objection was summarily overruled and I think properly so. But I think by the same token that he can raise the question in this Court because who else could? It seems, as your Honor has said, obvious that the defendant must be able to protect himself and if he can raise the question at all he ought to be able to raise it in the Court that will do him some good.

The Court: He ought to be able to raise it some place and this Court is the only Court where he can raise that.

Mr. Brown: That is right. I think that language is loose in that respect. I think it does apply to the second sovereignty. He cannot raise it in the second sovereignty. The first sovereignty must raise it in the second sovereignty *but the defendant may raise it in the first sovereignty, the way I look at it.*" (Italics ours.) [Clk. Tr. pp. 30-31.]

Appellant stated in opposition to petition for Writ of Habeas Corpus:

"That the only means by which the people of the State of California may be properly protected in this matter will be to prosecute said William Schmittroth according to the laws of the state." [Clk. Tr. p. 16.]

Under the special terms of probation imposed on petitioner Schmittroth by the Honorable James M. Carter, United States District Judge sitting in for the District Court at Los Angeles, California, the petitioner was to ". . . confine your activities to rural and mountain country. The probation officer will arrange to transfer supervision to the Northern District of California at your convenience." [Clk. Tr. pp. 9-10.]

Jurisdiction.

The jurisdictional basis for the District Court's action was not expressed in the proceedings below. Apparently, however, petitioner invoked the jurisdiction of the District Court. (28 U. S. C. 2243.) It was petitioner's theory that exclusive jurisdiction over the body of the petitioner was in the federal Courts by operation of Sections 3231 and 3651, Title 18, United States Code.

The petition for the Writ of Habeas Corpus was filed on February 8, 1955. The United States District Court ordered the Sheriff of San Diego County to show cause on February 17, 1955, and an answer to the petition for Writ of Habeas Corpus was filed, together with an affidavit in opposition to the petition. [Tr. pp. 12, 14.] On February 17, 1955, the United States, District Court ordered the discharge of the petitioner [Tr. p. 17], subject to the filing of findings of fact. [Tr. p. 31.] The District Attorney of San Diego filed a petition for a rehearing on February 21, 1955. Said petition was denied and findings of fact and conclusions of law were filed on March 11, 1955. [Tr. pp. 22-24.] The judgment was signed and filed on March 11, 1955, and entered on March 16, 1955. [Tr. p. 24.]

Notice of appeal was filed March 16, 1955. [Tr. pp. 25-26.] Thus, this Court has jurisdiction under 28 U. S. C. 2253 to hear and determine this appeal.

ARGUMENT.

I.

Appellant Cannot Complain on Appeal About Petitioner's Standing in Court to Bring a Writ of Habeas Corpus When He Assented Thereto in the District Court.

The record shows that at the hearing for the Writ of Habeas Corpus the appellant's counsel agreed that the petitioner could raise the question in this Court (United States District Court.) [Clk. Tr. pp. 30-31.] He, therefore, waived any objection that he might have had in regard to the petitioner's right to object to the State prosecution by a Writ of Habeas Corpus. He may not, on appeal, raise this objection for the first time. This proposition is supported by the case of *Lloyd v. Webster Apartments Company* (6th Cir., 1943), 135 F. 2d 971, at p. 973, wherein the Court said:

"The case before us presents no meritorious questions for review. With regard to the orders complained of, appellant, by her acquiescence, personally or through her counsel of record, is bound and now precluded from raising the issues on appeal."

II.

A Federal Probationer May Raise in the Federal District Court the Question of the Power of the State to Prosecute Him Without the Consent of the Federal Authorities.

The appellant cites many cases for the proposition that "the application of the rule of comity is solely a question to be resolved as between the two sovereigns." (App. Br. pp. 4-5.) Of these cited cases, all except the case of

Ponzi v. Fessenden, 258 U. S. 254, had the question of the consent of the sovereign first acquiring jurisdiction raised in the sovereign that acquired jurisdiction second. In the instant case, however, the issue of the first sovereign's consent was raised in the first sovereign's jurisdiction. The propriety of the question being so raised was conceded by the appellant in the trial court. [Clk. Tr. pp. 30-31.]

The question of consent was raised in the sovereignty first acquiring jurisdiction in the case of *Ponzi v. Fessenden*, *supra*; however, it is to be noted in that case there was express consent by the first sovereign by way of complying with the second sovereign's Writ of Habeas Corpus Ad Prosequendum. In an instance where the sovereign which first acquires jurisdiction expressly consents, as in the case of *Ponzi v. Fessenden*, *supra*, by compliance with a Writ of Habeas Corpus Ad Prosequendum there is no doubt that it is a question solely between the two sovereigns and the prisoner may not complain.

The question of the first sovereign's consent may be raised by a probationer in the courts of the first sovereign. In the case of *Grant v. Guernsey* (10th Cir., 1933), 63 F. 2d 163, the Court held that a federal probationer could object in the United States District Court by means of a Writ of Habeas Corpus to a State prosecution for a crime he committed before the time he was placed on probation. The County District Attorney opposed and the Justice of the Peace ruled with him and held *Guernsey* to appear at the next term of the State Court.

Guernsey then filed the petition for a Writ of Habeas Corpus in the United States District Court. The writ was granted and the Court said the following, in affirming the order discharging *Guernsey* from State custody, at page 164:

“There can be no doubt *Guernsey* was under the jurisdiction of the federal court, subject to its orders under the probation statute at any time; and when the justice of the peace issued his warrant for the arrest of *Guernsey* and then held him for trial on the state charge and that he abide the judgment of the state court, there was a direct interference with federal jurisdiction, and a violation of the rule of comity between federal and state courts.

“In *Taylor v. Taintor*, 16 Wall. 366, 370, 21 L. Ed. 287, it is said: ‘Where a State court and a court of the United States may each take jurisdiction, the tribunal which first gets it holds it to the exclusion of the other, until its duty is fully performed and the jurisdiction invoked is exhausted; and this rule applies alike in both civil and criminal cases. It is indeed a principle of universal jurisprudence that where jurisdiction has attached to person or thing, it is—unless there is some provision to the contrary—exclusive in effect until it has wrought its function.’

“In *Ponzi’s Case*, *supra*, the court said: ‘The chief rule which preserves our two systems of courts from actual conflict of jurisdiction is that the court which first takes the subject-matter of the litigation into its control, whether this be person or property, must be permitted to exhaust its remedy, to attain which it assumed control, before the other court shall attempt to take it for its purpose.’ But it was there held that a statute gave to the Attorney General such control of the convict after he was impris-

oned under the sentence as to authorize him to consent to the convict's trial in a state court. No statute is called to our notice, and we know of none, that gives to any officer the right here claimed by counsel representing the state. No application was made to the United States District Judge, and no authority cited holding that he had the power and it was his duty to release control over Guernsey for prosecution in the state court with or without condition that he be released to the federal court after trial in the state court; and if there be that power whether it is an absolute duty or discretionary, and reviewable on appeal. But those questions are not here on the record. Appellee was prosecuted and held under bail bond by the justice of the peace as by claimed right. The county attorney seems to have convinced him that it was by right of comity. The facts justified the issuance of the writ and appellee's discharge. In *Taylor v. Taintor*, *supra*, it was held that the giving of a bail bond did not discharge a prisoner but only as delivering him into the custody of his sureties. Likewise in *Mackenzie v. Barrett* (C. C. A.), 141 F. 964, 5 Ann. Cas. 551, and *Adamy v. Parkhurst* (C. C. A.), 61 F. (2) 517."

III.

The Lack of Objection by the United States Prior to the Time It Had Knowledge of the State Action Does Not Imply Consent.

Appellant contends, "the District Court erred in its failure to attribute any significance to the lack of objection by the Federal Government in the State proceeding. The court's finding of lack of consent by the Federal Government predicated upon such a theory, was errone-

ous.” (App. Br. p. 5.) *Amicus curiae* respectfully represents, in reply to appellant’s contention, as follows:

(1) The United States did object to the jurisdiction of the State of California by issuance of a Writ of Habeas Corpus.

(2) The presumption in this court is that the ruling of the trial court was correct. *Jernigan v. The Southern Pacific Company* (9th Cir., 1955), 222 F. 2d 245. *Dana-her v. United States* (8th Cir., 1950), 184 F. 2d 673. The burden is upon appellant to show error. *Jernigan v. The Southern Pacific Company* (9th Cir., 1955), 222 F. 2d 245. The record fails to disclose any knowledge by the District Court or by any government official of the State proceedings at any time prior to the filing of the petition for the Writ of Habeas Corpus by the petitioner. It also fails to disclose any request for the production of the person of the petitioner in any State actions made to the United States.

It would therefore appear that appellant’s contention that “the District Court erred in its failure to attribute any significance to the lack of objection by the Federal Government in the State proceeding” is without merit, in view of the fact that the United States had no knowledge of the State action. The fact that the United States made no objection does not imply consent. One cannot be said to consent to that about which he knows not.

IV.

The State of California May Not Proceed With Its Assertion of Jurisdiction Over a Federal Probationer Without the Express or Implied Consent of the United States.

A second sovereign acquiring jurisdiction over a person, who, is at the time in the custody of another sovereign, may not proceed with its prosecution unless it has express or implied consent of the sovereign who first acquired jurisdiction.

Express consent may be granted by compliance of the sovereign first acquiring jurisdiction with a Writ of Habeas Corpus Ad Prosequendum issued by the second sovereign. Consent may be inferred from acts of the first sovereign: (a) If the first sovereign has notice of the proceeding and refuses to complain; (b) If the first sovereign refuses to issue a Writ of Habeas Corpus upon petition of the person in the first sovereign's custody.

In the instant case, however, there is no showing that the first sovereign knew of the second sovereign's assertion of custody until the matter was presented by the probationer on a petition for a Writ of Habeas Corpus. It surely cannot be contended that the first sovereign impliedly consented to the action of the second sovereign when it never had notice that there was such action.

It is to be noted that the Ninth Circuit has expressed assent to the rule that the second sovereign may not proceed to trial of a person in the custody of another sovereign without the express or implied consent of the first

sovereign. In the case of *Stamphill v. Johnson* (9th Cir., 1943), 136 F. 2d 291, the facts were briefly as follows:

The petitioner was serving a life sentence for a state conviction in Oklahoma when he was surrendered by the Warden of the State Penitentiary of Oklahoma to the United States Marshal for the Western District of Oklahoma for trial in the Federal Court. He was convicted and sentenced by the United States District Court for the Western District of Oklahoma and was incarcerated in the United States Penitentiary, Alcatraz, California. He petitioned the United States District Court for a Writ of Habeas Corpus, the denial of which he appealed to the United States Circuit Court of Appeals for the Ninth Circuit. The denial of the writ was affirmed on appeal, the Court saying in that regard in part as follows:

“* * * in this case the state authorities did in fact surrender the appellant to the federal authorities, and thus, in effect, gave the federal court jurisdiction to try the appellant and to render judgment against him and to execute that judgment.”

On a petition for rehearing the Court gave a *per curiam* opinion in which it discussed the case of *Grant v. Guernsey*, 63 F. 2d 163, as follows, at page 293:

“In *Grant v. Guernsey*, *supra*, a majority of the Circuit Court of Appeals of the Tenth Circuit, one judge dissenting, held that a state court could not seize a person who is under probation by reason of a federal judgment during the probationary term and try him for a crime against the state without the consent of the federal court who had custody of him by reason of the probationary judgment and consequently affirmed the discharge of the prisoner. It should be noted that in the *Guernsey* case the peti-

tioner had been neither sentenced or tried by the state court. He had been held to answer to the state court by a justice of the peace. *This case conforms to the rule announced in our opinion that the consent express or implied of the sovereignty first acquiring jurisdiction and having possession of the person was necessary to a trial in the courts of the other sovereign.*" (Emphasis added.)

V.

The United States Objected to the State of California's Assertion of Jurisdiction by the Issuance of the Writ of Habeas Corpus.

The first sovereign expressed a denial of consent to the second sovereign's action when it issued the Writ of Habeas Corpus. This principle was recognized in the case of *Rawls v. United States* (10th Cir., 1948), 166 F. 2d 532 at page 534, where the court said concerning the case of *Grant v. Guernsey*, 63 F. 2d 163:

"In the Guernsey case, Guernsey was indicted in the United States District Court for the District of Kansas for Federal law violation. He pleaded guilty and was sentenced to a term of three and one-half years and was then placed on probation for the term of the sentence. While thus on probation, he was arrested by the county attorney of Montgomery County, Kansas, for prosecution in the State Courts. Guernsey protested that he was under the jurisdiction of the Federal Court and that the state action was an interference with the Federal jurisdiction. When this protest was ignored, he began a habeas corpus action in the Court of the Federal Judge who had placed him on probation. The hearing on the petition for the writ was held before the Federal Judge who had placed Guernsey on probation and who had continuing jurisdiction over him. He or-

dered his discharge. Thus it is clear that there was no consent to the surrender of Guernsey to the state by the Federal Judge who continued to exercise jurisdiction over him. On the other hand, it affirmatively appears that the Federal Judge having Guernsey under his jurisdiction objected to the interference with his jurisdiction.

“Even though Guernsey could not himself have challenged the state’s violation of the rule of comity in the absence of a consent to a waiver of the jurisdiction of the Federal Court, his petition for the writ did call the violation to the attention of the Federal Judge under whose jurisdiction he continued to remain, and he took appropriate action to register his disapproval thereof. He had the power to protect his jurisdiction and could have taken independent action no matter how the violation was called to his attention.”

This same principle was recognized in the case of *Lu Woy Hung v. Haff* (9th Cir., 1935), 78 F. 2d 836, the court at page 837 said:

“Appellant relies on *Grant v. Guernsey*, 63 F. 2d 163, wherein the Circuit Court of Appeals for the Tenth Circuit affirmed the order of the District Court discharging appellee from the custody of the state authorities. In that case appellee had been indicted in the District Court of the United States for Kansas for violation of the National Banking Act and pleaded guilty. He was sentenced to confinement in the penitentiary for a term of three and one-half years, but the District Judge placed him on probation during the term of sentence, requiring the probation officer to report on his conduct every sixty days. Thereafter, during the period appellee was on probation, appellant instituted criminal proceedings

against appellee in the state court, and he was ordered 'to remain there, not depart without leave and abide the judgment of that court.' Appellee petitioned the District Court of the United States for Kansas for a Writ of habeas corpus which was granted, and appellee was discharged. That case is distinguished from the case at bar because there the District Court of the United States which had prior jurisdiction over the appellee in the criminal case refused to relinquish custody of the petitioner to the state court."

VI.

The United States District Court Is Presumed to Have Taken Into Consideration the Facts Before It When It Exercised Its Discretion in Objecting to the State of California's Assertion of Jurisdiction Over a Federal Probationer.

The United States District Court for the Southern District of California did not abuse its discretion by failing to consent to the second sovereign's exercise of its jurisdiction.

The appellant contends that the District Court abused its discretion in that it gave the original probation order no consideration. (App. Br. p. 9.) The record shows that the probation order was before the court at the time that it exercised its jurisdiction. [Clk. Tr. pp. 9-11.] The presumption is that official duty is regularly performed. Therefore, it would be presumed that the District Court took into consideration the facts then before it. The burden is on the appellant to show error. He has made no such showing and therefore, it is to be presumed that the District Court did not err. (*Jernigan v. The Southern Pacific Company* (9th Cir., 1955), 222 F. 2d 245.)

Appellant also contends that the District Court gave no consideration to the fact that no restitution was ordered and, therefore, the District Court was not aware of the petitioner's alleged prior criminal act. (App. Br. p. 9.) The fact that no restitution was ordered does not necessarily show that the District Court was not aware of the alleged prior criminal acts of the appellee when he was put on probation. The fact that no restitution was ordered was before the District Court when it granted the Writ of Habeas Corpus. [Clk. Tr. p. 16.] To not have considered the facts before it would have been error. The appellant makes no showing that there was error and the burden is upon him to so show. In absence of such a showing, the appellate court must assume that the court below acted properly. (*Jernigan v. The Southern Pacific Company* (9th Cir., 1955), 222 F. 2d 245.)

Appellant further contends that the District Court abused its discretion when granting the Writ of Habeas Corpus in that it did not consider that such action might frustrate the state trial and that it might be tried later at the end of probationer's period of probation. The record shows that the District Court took into consideration the fact that the probationer could be tried by the State of California at the end of the five-year probation. (App. Br. pp. 9-10.) In that regard, the Honorable Peirson M. Hall stated "In doing that, I do not think that I am destroying the jurisdiction of the state; I am merely delaying it because, as I view the state's statutes, you can preserve your jurisdiction and preserve the statute of limitations over the defendant by causing him to be indicted by your grand jury and merely holding that indictment until the expiration of the term of his probation." [Clk. Tr. p. 29.]

Appellant also contends that the District Court abused its discretion in not considering the fact that it was of interest to both sovereigns to work out their problem in an "orderly fashion." (App. Br. p. 10.) The record shows that at the time the District Court granted the Writ of Habeas Corpus it had before it the fact that the State of California had never made application to the United States for consent to prosecute or incarcerate the federal probationer. [Clk. Tr. p. 33.] It would seem that the proper procedure for a sovereign to take in a case of this nature in the interests of working out the problem in an "orderly fashion" would be to serve a Writ of Habeas Corpus ad Prosequendum on the federal probation officer. It would also seem that this sovereign, who had made no application for consent from the United States and without any consent had seized a federal probationer, should not be heard to complain that the District Court of the United States had not considered the advantage to both sovereigns in working things out in an "orderly fashion."

The appellant further contends that the District Court did not consider whether or not the Writ of Habeas Corpus should be granted and only considered the question of whether or not the petitioner had standing to raise the question of comity and the jurisdiction of the State Court. (App. Br. p. 10.) The record shows that the court had before it the fact that the petitioner was a federal probationer [Clk. Tr. p. 22], and that under the terms of probation he was to confine his activities to rural and mountain country [Clk. Tr. p. 10]; and the fact the State of California had never asked for nor been given permission to prosecute or incarcerate the petitioner. [Clk. Tr. p. 33.] Again the appellant, having

the burden to show error, has failed to show any. In the absence of such a showing, the appellate court must presume that the court below acted properly. (*Jernigan v. The Southern Pacific Company* (9th Cir., 1955), 222 F. 2d 245.)

Conclusion.

It is respectfully submitted that the appellant cannot complain in this Court to the granting of the Writ of Habeas Corpus because he acquiesced in it in the trial court. The granting of the Writ of Habeas Corpus was a proper method for the District Court to refuse its consent to the state prosecution of a federal probationer. Whether or not the Writ should be issued is within the discretion of the District Court. The District Court did not abuse its discretion in issuing the Writ. Therefore, appellant's appeal should be dismissed.

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No. 14,733

United States Court of Appeals
For the Ninth Circuit

BERT STRAND, Sheriff of San Diego
County, State of California,

Appellant,

VS.

WILLIAM SCHMITTROTTH,

Appellee.

APPELLANT'S PETITION FOR A REHEARING EN BANC.

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FILED

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PAUL P. O'BRIEN, CLERK

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United States Court of Appeals For the Ninth Circuit

BERT STRAND, Sheriff of San Diego
County, State of California,

Appellant,

vs.

WILLIAM SCHMITTROTH,

Appellee.

APPELLANT'S PETITION FOR A REHEARING EN BANC.

*To the Honorable Judges Healy, Bone and Chambers
of the United States Court of Appeals for the
Ninth Circuit:*

Appellant petitions this Honorable Court for a rehearing *en banc* in the above entitled matter.

This petition is made on the ground that this case involves important questions of federal-state relations which have received different treatment in different United States Courts of Appeal and should receive the attention of the whole Court.

FACTS.

The District Court ordered a federal probationer released from the sheriff. The sheriff was detaining

the probationer for trial in the state court. No objection by a representative of the federal government has ever been made in the state court.

ARGUMENT.

I.

THE OPINION OF THE MAJORITY FOSTERS A RUDE CLASH BETWEEN JURISDICTIONS BY PERMITTING THE RELEASE OF A PRISONER IN STATE CUSTODY. THE DOCTRINE OF COMITY WAS DESIGNED TO AVOID SUCH CONFLICT.

A. The majority has either misstated, or appellant has not made his view involving comity clear.

The Court states: "Appellant argues that the state court does have jurisdiction to try appellee while he is a federal probationer *unless* the federal court *or* appropriate federal authorities object to exercise of state jurisdiction over the accused." This is, in part, a correct statement of our views. However, this contention was supplemented with the statement on page 8 of Appellant's Brief as follows: "The orderly administration of justice would seem to require the proper agent of the first sovereign to object in the Court of the second sovereign."

It has been, and is, the view of the appellant that the second court, in this case the state court, having jurisdiction of the person, may proceed unless there is an objection on behalf of the federal court, *which is made in the state court*. Only then must the second court, as a matter of comity, decline to exercise its jurisdiction.

At the core of our contention lies the question of consent and the manner and procedure by which the first sovereign may enter its objection. We contend that the second court has the right to assume consent in the absence of an express objection by the first sovereign in the tribunal of the second sovereign.

The rule of comity which requires the objection to the jurisdiction of the second court to be made in the second court, and which leaves to the second court the power to decline to exercise its jurisdiction, was designed to prevent the very thing which occurred in the present case. The rule of comity was designed to promote conciliation and harmony, rather than alienation and discord between tribunals. The requirement that the objection by the first sovereign be made in the tribunal of the second sovereign operates to bring about this harmony in two ways: (1) It gives the second sovereign the right to pass upon the question of whether it should decline as a matter of comity to exercise its jurisdiction; and (2) It prevents the peremptory release of the prisoner of the second sovereign by the first sovereign.

The writ of habeas corpus has never been used to enforce a rule of comity. The writ of habeas corpus is not a proper procedure to review the application or the failure to apply the rule of comity when a second court has acquired jurisdiction. (*U. S. v. Morse*, 267 U.S. 80, 82; *Stamphill v. Johnston*, (9th Cir.) 136 F.2d 291, 292; *U. S. v. Marrin*, 17 F.2d 476, 479-480.)

We have also contended that the petitioner has a right of appeal from the lower state courts to higher state courts. Likewise, he has the right of appeal from the state court to the United States Supreme Court. The writ of habeas corpus was not designed to prevent a state court from acting correctly or incorrectly in the exercise of its jurisdiction.

This contention is apparently answered by the majority opinion with the case of *Bowen v. Johnston*, 306 U.S. 19, 26-27 (1939). In the *Bowen* case at page 23 the court stated: "the scope of review on habeas corpus is limited to the examination of the jurisdiction of the court whose judgment and conviction is challenged". This supports our contention that the writ of habeas corpus was not designed to enforce a rule of comity but is limited to situations where a second court is without jurisdiction.

Furthermore, in the *Bowen* case, both the trial tribunal and the habeas corpus tribunal were Federal District Courts. This is important, because of the policy Congress has expressed at 28 U.S.C. 2254, which requires exhaustion of state remedies. Such doctrine is not a statutory requirement in federal cases. However, it should be noted that the procedure followed in *Bowen v. Johnston* is no longer proper even in the federal court. The petitioner would be first required to file for relief under 28 U.S.C. 2255, thus giving the trial court an opportunity to pass on the question before habeas corpus would be available in the second federal court.

In present case no objection by a representative of the federal government was made in the state court.

B. The majority opinion leaves unsolved the problem of assumed consent and gives the State Courts no guidance among conflicting federal cases on this question.

It has been appellant's view that the District Court erred by refusing to give any consideration to the fact that the federal government had not entered an objection *in the state court* over the petitioner. We have urged the view followed by the Second Circuit. The case of *U. S. ex rel. Pasela v. Fenno*, 167 F.2d 593, 596, held that in the absence of an objection expressed by the first jurisdiction in the tribunal of the second jurisdiction the second jurisdiction may assume the consent of the first jurisdiction. Such a rule is a common sense element of the rule of comity involved in the present case. Any other rule would compel the State to inquire whether each prisoner is a federal probationer; in view of the enormous number of prosecutions in state courts every year the administrative burden of such a requirement would be enormous. The rule of comity permits, and common sense demands, that the second jurisdiction assume the consent of the first jurisdiction in the absence of an express objection by the first jurisdiction in the tribunal of the second jurisdiction.

- C. The majority opinion draws an incorrect conclusion from its finding that the probationer has standing to raise and rely on the rule of comity, that the first sovereign acquiring jurisdiction is entitled to retain jurisdiction.

The court concludes that the appellee has the standing to raise the question of exercise of state court jurisdiction over him. Even assuming that appellee has the right in some manner, including habeas corpus, to bring to the attention of the court the fact that the proceedings have been commenced against him in a state court, nevertheless it does not follow that the federal court should interfere with the state court's jurisdiction and decide whether the state court should or should not apply the rule of comity. The rule of comity demands that the objection to the second court's jurisdiction be made in the tribunal of the second court. The proper procedure for the federal court when it has been brought to its attention, in whatever manner, that the state court is proceeding against the probationer, is to enter an express objection in the state court. In the absence of said express objection, the state court is entitled to assume consent to its jurisdiction.

No objection by the federal court or a representative of the federal court was ever made in the state court.

II.

IF THE MAJORITY OPINION IS BASED ON THE GROUND THAT THE STATE LACKS JURISDICTION OVER A PROBATIONER, IT HAS CREATED AMBULATORY ENCLAVES WHO ARE FREE FROM ANY DETENTION BY STATE OFFICERS ACTING AS STATE OFFICERS, INCLUDING DETENTION INCIDENT TO ARREST FOR ANY CRIME AGAINST THE PEOPLE OF THE STATE.

The majority opinion states that the same result obtains, either on the theory of comity between federal and state courts, or on the theory of federal supremacy. The latter theory would effectively deprive the state and any of its officers from enforcing any of its laws against a federal probationer. For if the lower state court is without jurisdiction and the sheriff in the instant case is powerless to detain the probationer, then all state officers are powerless to prevent and to detain any probationer for violating any state law, since probationer is in *custodia legis* of the Court of the United States. Such a result is neither desirable nor necessary. The majority opinion is in conflict with numerous other decisions which disclaim the theory that the state court is without jurisdiction in the present situation.

In the case of *U. S. ex rel. Pasela v. Fenno*, 167 F.2d 593, the Second Circuit expressly declined to follow the holding of decision of *Grant v. Gurnsey* (10th Cir.), 53 F.2d 163, insofar as it held that the second court, assuming jurisdiction, lacks jurisdiction. To like effect is the case of *U. S. ex rel. Spellman v. Murphy* (7th Cir., 1954) 217 Fed.2d 247. Also see, *Hebert v. Louisiana*, 272 U.S. 312, 315; *Werntz v. Looney* (10th Cir.), 208 F.2d 102; *Rahls v. U. S.* (10th Cir.), 166

F.2d 532; *U. S. v. Farrell* (8th Cir.), 87 F.2d 957; *People ex rel. McCarthy v. Reagan*, 58 N.E.2d 872 (389 Ill. 172); *Wilkinson v. Youell*, 23 S.E.2d 356 (180 Pa. 321).

The majority apparently concedes that the state court is not without jurisdiction unless the federal authorities object. It should appear clear that the State, according to the present case, has jurisdiction since no objection has been made to its jurisdiction in its tribunal. We have pointed out above the discord and the disorderly state of affairs created by the use of the writ of habeas corpus to enforce such a rule prior to any objection by an agent of the federal government made in the state court.

The court in an attempt to justify the use of a writ of habeas corpus has relied on the case of *In re Neagle*, 135 U.S. 1. The rationale of that decision is that the marshal was an instrumentality and agent of the federal government. It is hoped that by this citation the majority is not making the probationer an instrument or agent of the federal government.

Likewise, the court has completely failed to answer our contention that the District Court was without power under Section 2241, Title 28 of the United States Code to grant the writ of habeas corpus to petitioner.

CONCLUSION.

It is respectfully submitted that the petition for rehearing *en banc* be granted.

Dated, San Francisco, California,

June 1, 1956.

Respectfully submitted,

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CLARENCE A. LINN,

Chief Assistant Attorney General of the State of California,

ARLO E. SMITH,

Deputy Attorney General of the State of California,

*Attorneys for Appellant
and Petitioner.*

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for appellee and petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing en banc is well founded in point of law as well as in fact and that said petition for a rehearing en banc is not interposed for delay.

Dated, San Francisco, California,
June 1, 1956.

ARLO E. SMITH,
Deputy Attorney General of the State of California,
*Of Counsel for Appellant
and Petitioner.*

No. 14733

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERT STRAND, Sheriff of San Diego County, State of
California,

Appellant,

vs.

WILLIAM SCHMITTROTH,

Appellee.

BRIEF OF AMICUS CURIAE.

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FILE

OCT 30 1956

PAUL P. O'BRIEN, CLERK

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for appellee and petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing en banc is well founded in point of law as well as in fact and that said petition for a rehearing en banc is not interposed for delay.

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June 1, 1956.

ARLO E. SMITH,

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United States Attorney,

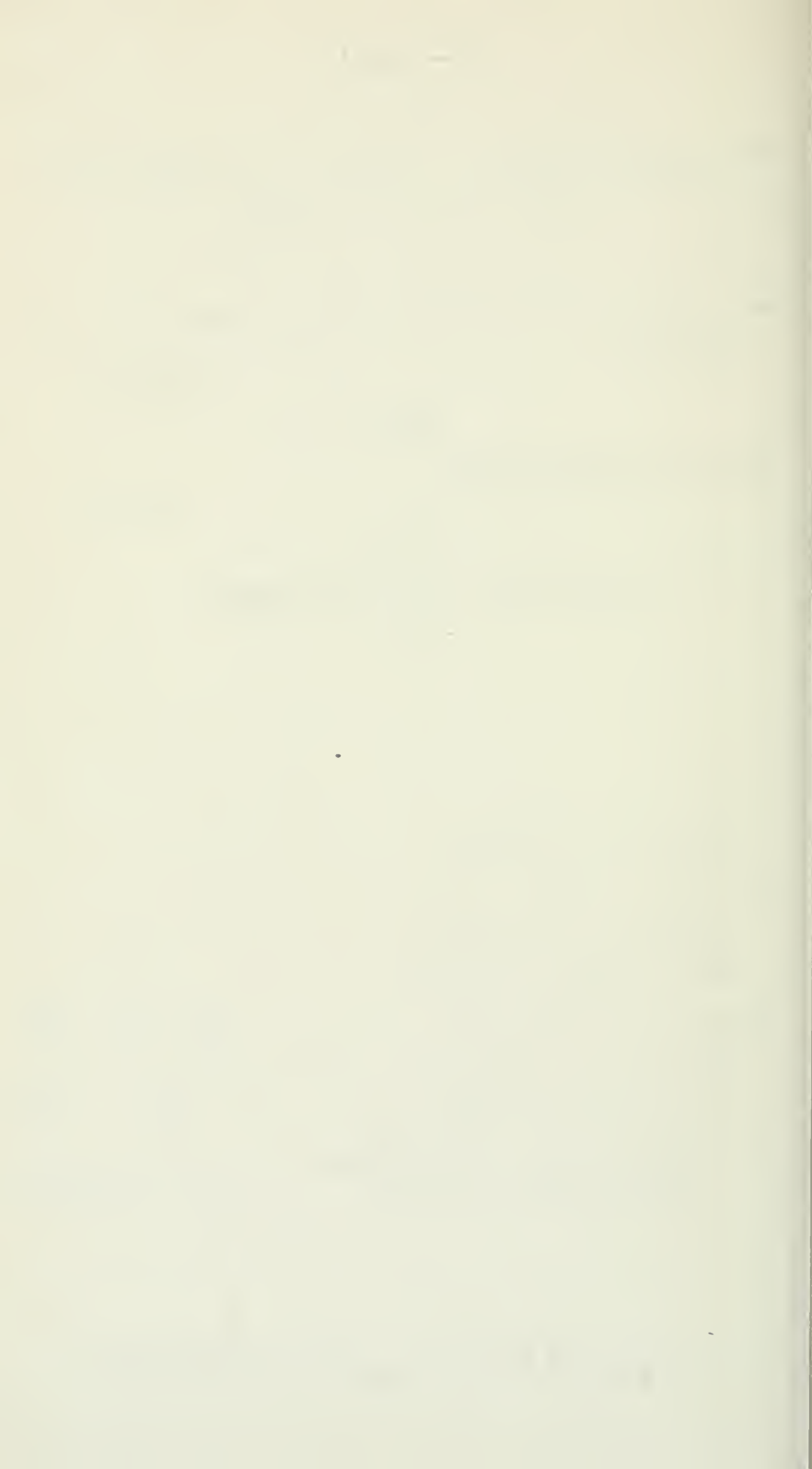
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FILE

OCT 30 1956

PAUL P. O'BRIEN, CL



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No. 14733

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERT STRAND, Sheriff of San Diego County, State of
California,

Appellant,

vs.

WILLIAM SCHMITTROTH,

Appellee.

BRIEF OF AMICUS CURIAE.

Jurisdiction.

The basic jurisdiction of the District Court is founded upon Title 18, U. S. C. A., Section 3231 (June 25, 1948, C. 645, 62 Stat. 826) and Title 18, U. S. C. A., Section 7 (June 25, 1948), and initially arose in this case by reason of a violation of Title 18, U. S. C. A., Section 2314 (June 25, 1948, C. 645, 62 Stat. 806 amended May 24, 1949, C. 139, Section 45, 63 Stat. 96). Probation was granted under Title 18, U. S. C. A., Section 3651 (June 25, 1948, C. 645, 62 Stat. 842) and a petition for habeas corpus brought by the probationer under Title 28, U. S. C. A. 2241 (June 25, 1948, C. 646, 62 Stat. 964 amended May 24, 1949, C. 139, Section 112, 63 Stat. 105).

The jurisdiction of this Court was invoked under the provisions of Title 28, U. S. C. A., Section 1291 (June 25, 1948, C. 646, 62 Stat. 929), and Rules 37 and 39 of

the Federal Rules of Criminal Procedure, Title 18, U. S. C. A. (as amended December 27, 1948, eff. January 1, 1949).

This brief is filed as *Amicus Curiae* pursuant to an order of this Honorable Court, dated October 1, 1956.

Statement of the Case.

This appeal was originally presented to this Honorable Court by appellant, the Sheriff of San Diego County, California, from an order of the District Court for the Southern District of California, Pierson Hall, Judge, granting a writ of habeas corpus to the appellee Schmittroth, a federal probationer, commanding his release by the said Sheriff of San Diego County who held him pending his trial for a prior State offense.

The pertinent facts are as follows:

On August 29, 1953, appellee Schmittroth (hereinafter sometimes referred to as appellee) cashed a check in a San Diego, California, drug store, payable to William Roth (an oft used alias of appellee) in the sum of \$135.00 and signed C. Robert Johnson. Also on August 29, 1953, appellee cashed a check at the Senator Cafe in San Diego, drawn to the order of William Roth in the sum of \$135.00 and likewise signed C. Robert Johnson. Both checks were drawn on the United States National Bank in San Diego and upon presentment thereto both checks were dishonored, there being no account in the name of C. Robert Johnson.

As a result of these two transactions a complaint was issued on September 15, 1953 by the Municipal Court of the San Diego Judicial District charging "William Roth" (Appellee) with the crime of Uttering a Check Bearing

a Fictitious Name. At that time a warrant issued directing the arrest of appellee.

Appellee was not immediately apprehended on the San Diego warrant of September 15 and on February 9, 1954, in St. Petersburg, Florida, he caused to be transported in interstate commerce a falsely made check in the amount of \$60.00 drawn on the Northwest Bank and Trust Company, Davenport, Iowa, signed A. R. Bruns and made payable to William Schmittroth (appellee).

On November 24, 1954, pursuant to the provisions of Criminal Rule 20, Title 18, U. S. C. A., appellee consented to the transfer of the case, arising out of the transaction of February 9th, from the Southern District of Florida to the Southern District of California for the purpose of entering a plea of guilty to an indictment charging him with a violation of Title 18, U. S. C. A., Section 2314.

On January 17, 1955, appellee was convicted upon his plea of guilty in the United States District Court for the Southern District of California and was sentenced by the Honorable James M. Carter to imprisonment for a period of ten years said sentence to be suspended and defendant placed upon probation for a period of five years.¹

¹The pertinent portion of the judgment of the court read as follows:

"It is adjudged that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of ten years; and it is ordered that the execution of said sentence be and hereby is suspended and the defendant is placed on probation for a period of five years, on condition that the defendant obey all laws, local, state and Federal, that he comply with the rules and regulations of the Probation Officer and report thereto as required and that the defendant confine his activities to

On January 17, 1955, the same date appellee was placed upon Federal Probation, he was delivered into the custody of the San Diego Police Department upon the outstanding warrant of September 15, 1953 (*supra*). Appellee thereafter admitted that he had written and passed the two bad checks on August 29, 1953.

On February 8, 1956 appellee petitioned the United States District Court for the Southern District of California, Southern Division, for a Writ of Habeas Corpus alleging that he was unlawfully detained and confined by

rural and mountain country. The Probation officer will arrange to transfer supervision to the Northern District of California at defendant's convenience."

The rules and regulations of the Probation Officer above referred to are contained in the Conditions of Probation [Tr. 9] viz.:

CONDITIONS OF PROBATION
United States District Court for the
Southern District of California
Docket No. 23975

To Mr. Wm. Nicholas Schmittroth.

Address.....

In accordance with authority conferred by the United States Probation Law, you have been placed on probation on this date, January 17th, 1955, for a period of 5 years by the Hon. James M. Carter, United States District Judge, sitting in and for this District Court at Los Angeles, California.

It is the order of the Court that you shall comply with the following general and special conditions of probation. The general conditions are as follows: (a) Refrain from the violation of any state and federal penal laws. (b) Live a clean, honest and temperate life. (c) Keep good company and good hours. (d) Keep away from all undesirable places. (e) Work regularly. When out of work, notify your probation officer at once. (f) Do not leave or remain away from the city or town where you reside without permission of the probation officer. Notify your probation officer at once if you intend to change your address. (g) contribute regularly to the support of those for whose support you are legally responsible. (h) Follow the probation officer's instructions and advice. The Probation Law gives him authority to instruct and advise you regarding your recreational and social activities. (i) Report promptly on the dates set forth. If for any unavoidable rea-

Bert Strand, the sheriff of San Diego County (hereinafter sometimes referred to as appellant) inasmuch as he was, at the time of his seizure and confinement, a Federal Probationer and as such was in the sole and exclusive custody of the United States and was accordingly immune to prosecution by the State unless the United States expressly consented to the prosecution which it had not done. An order to show cause issued to which appellant Strand answered alleging that he held appellee upon a valid order of a Court of California and that detention by a State official of a prisoner who is subject to the

son you are unable to do so, communicate with your probation officer without delay.

The special conditions ordered by the Court are as follows: Execution of sentence is suspended and you are placed on probation for 5 years on condition that you obey all laws, local, state and Federal, that you comply with the rules and regulations of the Probation Officer and report thereto as required, and that you confine your activities to rural and mountain country. The Probation Officer will arrange to transfer supervision to the Northern District of California at your Convenience.

You are hereby advised that under the law of the Court may at any time revoke probation for cause, modify the conditions of probation, and reduce or extend the period of probation. You are subject to arrest by the probation officer without a warrant. At any time during the period of probation or within 5 years from the date you were placed on probation the court may issue a warrant and revoke probation for a violation occurring during the period of probation.

The Court has placed you on probation, believing that if you sincerely try to obey and live up to the conditions of your probation, your attitude and condition will improve both to the benefit of the United States and of yourself.

You will report as follows: You will render written reports on the last day of each month and mail or bring to Mr. C. H. Meador, Chief U. S. Probation Officer, 533 Post Office Building, Los Angeles 12, California.

C. H. MEADOR,
Chief U. S. Probation Officer.
/s/ WM. N. SCHMITTROTH,
Probationer.

[Endorsed] : Filed February 10, 1955.[8]

custody of the Federal Court is not illegal until such time as the Federal Court shall refuse permission for the detention which had not been done. Thereafter, on February 17, 1955 the matter came on for hearing before the Honorable Pierson Hall, and after considering the papers on file and the oral arguments of counsel, Judge Hall ordered appellant to discharge appellee from any confinement by reason of the San Diego commitment. Appellant's "Petition for Rehearing" by the District Court being denied and the final judgment being entered on March 11, 1955, Strand appealed to this Honorable Court. Up to this point the United States had not participated in the proceedings but pursuant to the request of this Honorable Court, on January 30, 1956, this office filed an *Amicus Curiae* brief on behalf of the United States.

In May 3, 1956, Judge Bone handed down the opinion of the majority affirming the order of Judge Hall granting appellee's petition for a Writ of Habeas Corpus. Judge Healy joined in the majority. Judge Chambers dissented. (*Strand v. Schmittroth*, No. 14,733, 9th Cir., May 3, 1956, 233 F. 2d 598.)

Appellant filed his petition for a rehearing by the Court en banc which was denied by the majority on August 2, 1956. Judge Chambers again dissented (*Strand v. Schmittroth*, No. 14,733, 9th Cir., August 2, 1956, 235 F. 2d 756).

Appellant then filed a petition for a Writ of Certiorari in the Supreme Court of the United States. Thereafter, before the Supreme Court acted on said petition, on October 1, 1956 Judges Bone and Chambers constituting a

majority of the panel which had heard the case, vacated the panel's August 2nd Order which had denied the petition for rehearing and informed the Chief Judge that a rehearing en banc was desired. On the same date Judges Denman, Stephens, Pope, Fee and Chambers joined in signing an order for a rehearing en banc and granting the appellee and the United States, as *Amicus Curiae*, permission to file additional briefs. This brief is filed pursuant to that order.

Summary of Argument.

I.

INTRODUCTION, AND RESTATEMENT OF THE ARGUMENTS
ADVANCED IN THE PRIOR PROCEEDINGS IN THIS CASE.

II.

A PERSON ENLARGED UPON PROBATION IS NOT, BY REASON OF HIS PROBATION, IMMUNE FROM APPREHENSION, PROSECUTION, AND INCARCERATION BY THE AUTHORITIES OF A SECOND SOVEREIGN WHOSE LAWS HE HAS VIOLATED.

III.

EXAMPLES.

(a)

"SUPPOSE A STATE PROBATIONER VIOLATES THE FEDERAL KIDNAPPING STATUTE. THE FEDERAL BUREAU OF INVESTIGATION FINDS THE KIDNAPPER. CAN ITS OFFICERS ARREST THE CULPRIT? MUST THEY GET THE PERMISSION OF A STATE JUDGE TO ARREST HIM? IF THEY CAN ARREST HIM BUT MUST GET PERMISSION TO PROSECUTE, HOW LONG CAN THEY HOLD THE KIDNAPPER WHILE THEY WAIT FOR PERMISSION? IF THE JUDGE WHO HEARS THE HABEAS CORPUS DECIDES THE OTHER JURISDICTION . . . SHOULD PROSECUTE, THEN MAY THE PRISONER APPEAL CLAIMING AN ABUSE OF DISCRETION?"

(b)

"CAN A JUVENILE STATE PROBATIONER GO OUT, ROB A NATIONAL BANK, GET CAUGHT BY THE FEDERAL BUREAU OF INVESTIGATION, AND THEN TAUNT HIS ARRESTOR WITH 'YOU CAN'T ARREST ME. MY JUVENILE JUDGE SAID YOU COULDN'T TOUCH ME.'"

(c)

"WILL WE DENY THE GREAT WRIT [HABEAS CORPUS] TO ONE WHO COMMITS THE STATE OFFENSE AFTER HE GOES ON FEDERAL PROBATION BUT GRANT IT IF HIS STATE OFFENSE PRECEDES HIS FEDERAL OFFENSE IN POINT OF TIME?"

(d)

"SUPPOSE THE FEDERAL PROBATIONER IS AT SAN DIEGO AND THE SUBSEQUENT STATE OFFENSE AND ARREST ARE IN ALAMEDA COUNTY, CALIFORNIA, IN THE NORTHERN DISTRICT OF CALIFORNIA. THE APPLICATION FOR HABEAS CORPUS MUST BE MADE IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT. HOW WILL THAT WORK? WILL A JUDGE OF THE FEDERAL COURT IN THE NORTHERN DISTRICT EXERCISE THE SOUTHERN DISTRICT'S . . . DISCRETION AS TO WHETHER STATE PROSECUTION SHOULD GO AHEAD?"

(e)

"WHETHER THE JURISDICTION OF THE SECOND SOVEREIGN TO DETAIN AND TRY A PROBATIONER OF THE FIRST SOVEREIGN PREVAILS IN ABSENCE OF EXPRESS ASSENT BY THE FIRST SOVEREIGN?"

(f)

"WHETHER PROBATION FROM THE FIRST SOVEREIGN COMPLETELY INSULATES THE PROBATIONER FROM PROSECUTION BY SUBSEQUENT SOVEREIGNS DURING THE TERM OF HIS PROBATION?"

(g)

"WHETHER A PERSON ON PROBATION IS TO BE CONSIDERED IN THE CUSTODY OF THE LAW FOR ALL PURPOSES?"

ARGUMENT.

I.

Introduction and Restatement of the Arguments Advanced in Prior Proceedings in This Case.

At the outset it is helpful to consider briefly the arguments which have previously been advanced in this case both at the District Court level and in the initial hearing on appeal.

The precipitating factor here was the act of the State of California in attempting to exercise jurisdiction over appellee while he was subject to the control of the United States by reason of his Federal probation. The conflict results from the attempts to reconcile with appellee's probational status the long standing rule regulating Federal-State judicial relations, that the first court having jurisdiction of a person cannot, without its consent, be deprived by a second Court of the right to deal with that person until its jurisdiction be exhausted.

Judge Hall in ordering appellant to discharge appellee concluded that appellee was confined by the State of California without jurisdiction.

In this he assumed that appellee as a Federal probationer was within the custody and control of the United States and accordingly on the basis of *Grant v. Guernsey* (10th Cir., 1933), 63 F. 2d 163 (which allowed a writ of habeas corpus upon almost identical facts), he concluded that the State of California lacked immediate jurisdiction to try appellee in absence of the express consent of the United States which as the sovereign first acquiring jurisdiction over appellee had the right to exhaust its remedies upon him to the exclusion of the State.

Both appellant and appellee admit the well established principle that in our dual system of Government the sovereign (hereinafter termed "first sovereign") which first acquires jurisdiction over a criminal cannot be deprived of the right to deal with such person until its jurisdiction is exhausted and that no other Court has the right to interfere with such custody or possession. At this point their respective interpretations of the law diverge. Appellant views "The Rule" as one of comity and reasons that under "The Rule" the first sovereign acquires jurisdiction to deal with the person in question but not to the exclusion of the second sovereignty acquiring custody of the person (hereinafter called the second sovereign). It is his theory that the second sovereign likewise has jurisdiction but must merely delay its exercise until the first sovereign has exhausted its remedy. Thus if physical custody of the person be acquired by the second sovereign it could, *in absence of objection by the first sovereign*, try him without further ado. Appellant further contends that the person thus held lacks standing to raise the question of the rights of the first sovereignty, it being a matter solely between the two sovereigns. In any event he urges that even if the restrained person has in some way the right to raise the question of the first sovereigns interest, a Writ of Habeas Corpus from the first sovereign is not the proper manner in which the matter should be raised. This of course would follow if the second sovereign's jurisdiction was valid.

Appellee on the other hand sees "The Rule" as jurisdictional and contends that the jurisdiction of the first sovereign acquiring jurisdiction is exclusive since "it is a fundamental principle of law that jurisdiction of a *res* can be in only one place at a time." and the jurisdiction of the second sovereign arises only upon the

exhaustion or relinquishment of the jurisdiction of the first sovereign. The importance of this distinction is apparent since under appellee's theory if the second sovereign obtained custody of the person in question at any time prior to the exhaustion or relinquishment of the first sovereign's jurisdiction, it would hold him without jurisdiction and being thus restrained the person could properly obtain his release by habeas corpus from the courts of the first sovereign. Thus in the event the second sovereign possessed custody of the person and wished to try him, it could acquire the jurisdiction to do so only by obtaining the permission of the first sovereign, the action of the first sovereign being in effect a waiver of jurisdiction in favor of the second sovereign.

The District Court in granting the writ evidently took the view, that the jurisdiction of the second sovereign (the State here) over the appellee, was deferred until the United States was through with him and in accord with this view held that prosecution by the second sovereign could only be predicated upon actual or implied consent by the first sovereign. As he stated [Tr. 29]:

"In other words there must be an actual or an implied consent rather than a mere failure to object.

"I hold that there must be a consent, that there has been no consent in this case, and under *Grant v. Guernsey* the petitioner is entitled to the Writ.

"In doing that, I don't think that I am destroying the jurisdiction of the State. I am merely delaying it because as I view the State's statutes, you can preserve your jurisdiction and preserve the statute of limitations over this defendant by causing him to be indicted by your grand jury and merely holding that indictment until the expiration of the term of his probation."

The brief of the United States filed as *Amicus Curiae* on the previous consideration of this appeal, supported the views of the appellee Schmittroth and relied extensively on the Tenth Circuit case of *Grant v. Guernsey* (1933), 63 F. 2d 163 (*supra*) and took the position that a second sovereign acquiring jurisdiction over a person who, is at the time in the custody of another sovereign, may not proceed with its prosecution unless it has express or implied consent of the sovereign which first acquired jurisdiction. It was also urged that a Federal probationer may raise by applying for a Writ of Habeas Corpus in the Federal District Court, the question of the power of the State to prosecute him without the consent of the Federal authorities.

The opinion of the majority (*Strand v. Schmittroth* (9th Cir., May 3, 1956, No. 14,733), 233 F. 2d 598), relied in many particulars on the views expressed in the *Amicus* brief and specifically followed *Grant v. Guernsey* (10th Cir., 1933), 63 F. 2d 163 (*supra*). Additionally the majority opinion held that the State Court had jurisdiction over appellee and while appellee had no standing to raise the issue of the prior Federal jurisdiction, the action of the District Court in granting the Writ clearly indicated its objection to State action at that time, thus postponing the State's jurisdiction.

Attempts to apply the rationale of the opinion of *Grant v. Guernsey* to the practical problems of federal-state law enforcement compelled a reappraisal of the position taken by the government in the *amicus curiae* brief. We now conclude that our prior views lead to an unrealistic and unworkable result and that some other solution is necessary to insure the compatible administration of federal-state justice.

II.

A Person Enlarged Upon Probation Is Not, by Reason of His Probation, Immune From Apprehension, Prosecution, and Incarceration by the Authorities of a Second Sovereign Whose Laws He Has Violated.

As both appellant and appellee urge, it is of course the well established rule that as between two competing sovereigns the one which first acquires criminal jurisdiction over a person cannot be deprived of that jurisdiction by action of the other sovereign before it (the first sovereign) has exhausted or relinquished its jurisdiction. So fundamental to this case is the above stated rule that throughout the remainder of this brief it is often referred to merely as "The Rule."

The dual system of criminal justice inherent in our federal system of government if unrestrained could lead inevitably but to conflict between state and federal courts in the exercise of their respective criminal jurisdiction. This truism was early recognized and the aforestated rule evolved as a practical means of regulation where the two sovereigns simultaneously desired to adjudicate and regulate the same *res* or person. "The Rule" finds its basis in comity. While its initial development was in relation to dual judicial attempts to acquire the *res* in a civil action, "The Rule" later spread to and governs to a lesser extent federal-state relations in the administration of criminal justice. In the words of Mr. Justice Sutherland:

"The principle that when the jurisdiction of a court has attached it must be respected as exclusive until exhausted, is a rule of comity, having a wide application in civil cases but a limited one in criminal cases. *Peckham v. Henkel*, 216 U. S. 483, 486.

The mutual forbearance which two federal courts having coordinate jurisdiction should exercise to prevent conflicts by avoiding interference with the process of each other has 'perhaps no higher sanction than the utility which comes from Concord' *Covell v. Hayman*, 111 U. S. 176."

Morse v. United States (1925), 267 U. S. 80, 82.

Thus "The Rule" is nothing more than an expeditious method of cooperation between state and federal courts.

"The Rule" was introduced into the Federal Courts in the middle of the last century and has been increasingly adhered to ever since. It will be of aid in considering the problem here presented to trace briefly the development of "the Rule."

It is generally conceded that the leading case in this field is the twin case of *Ableman v. Booth* and *United States v. Booth*, considered and decided together at the December, 1858 term of the Supreme Court and reported in 62 U. S. 506, in which the Supreme Court of Wisconsin undertook to release on habeas corpus certain Wisconsin citizens convicted by the United States District Court in violation of the fugitive slave law. Of this case it was said in *In re Johnson* (1897), 167 U. S. 120 that:

"Ever since the case of *Ableman v. Booth*, 21 How. 506, it has been the settled doctrine of this court that a court having possession of a person or property cannot be deprived of the right to deal with such person or property until its jurisdiction is exhausted, and that no other court has the right to interfere with such custody or possession. This rule was reaffirmed in *Tarbles* case, 13 Wall. 397; in *Robb v. Connolly*, 111 U. S. 624; and *In re Spangler*,

11 Michigan 298, and with reference to personal property has become so often restated as to have become one of the maxims of law.”

It is to be noted that *Ableman v. Booth*, *Tarbles* case and *Robb v. Connolly* (*all supra*), each are concerned with the situation where the person seeking release was physically confined in the first two cases by officers of the United States, in the latter case by officers of the State of Oregon.

See also: *Ex parte Royall* (1886), 117 U. S. 241 which was concerned with a person held in physical custody by the sergeant of Richmond, Va.

Taylor v. Taintor (1872), 83 U. S. 366 contains a trenchant exposition of “The Rule” at page 370 where it is stated:

“Where a State court and a Court of the United States may each take jurisdiction, the tribunal which first gets it holds it to the exclusion of the other, until its duty is fully performed and the jurisdiction invoked is exhausted; and this rule applies alike in both civil and criminal cases. It is indeed a principle of universal jurisprudence that where jurisdiction has attached to person or thing, it is—unless there is some provision to the contrary—exclusive in effect until it has wrought its function.”

A landmark case in this field and one which was relied on both by appellee and by the trial court, is *Ponzi v. Fessenden* (1922), 258 U. S. 254. In that case Ponzi was held as a Federal prisoner in the State House of Correction by virtue of a mittimus issued by the Federal District Court. Subsequently to his aforesaid incarceration the State Court issued a Writ of Habeas Corpus

directing the master of the House of Correction to produce Ponzi before the State Court to answer certain outstanding indictments. The Attorney General of the United States, through his agent, in open Court stated that the United States had no objection to the State proceeding. Ponzi, denied a Writ of Habeas Corpus, appealed alleging that since he was in the exclusive custody of the United States the State lacked jurisdiction to try him. Although the court upheld the denial of the writ on Ponzi's lack of standing to raise the question, Mr. Justice Holmes stated at page 260:

“The chief rule which preserves our two systems of courts from actual conflict of jurisdiction is that the court which first takes the subject matter of the litigation into its control, whether this be person or property, must be permitted to exhaust its remedy, to attain which it assumed control, before the other court shall attempt to take it for its purpose.”

“The Rule” as evolved has found wide application in the Circuit and District Courts. *United States v. Murphy* (7th Cir., 1954), 217 F. 2d 247; *Werntz v. Looney* (10th Cir., 1953), 208 F. 2d 102; *United States v. Fenno* (2nd Cir., 1948), 167 F. 2d 593; *Rawls v. United States* (10th Cir., 1948), 166 F. 2d 532; *Stamphill v. Johnston* (9th Cir., 1943), 136 F. 2d 291; *Lunsford v. Hudspeth* (10th Cir., 1942), 126 F. 2d 653; *Wall v. Hudspeth* (10th Cir., 1940), 108 F. 2d 865; *Cato v. Smith* (9th Cir., 1939), 104 F. 2d; *Rohr v. Hudspeth* (10th Cir., 1939), 105 F. 2d 747; *Grant v. Guernsey* (10th Cir., 1933), 63 F. 2d 163; *United States v. Robinson* (D. C. W. D. Ark., 1947), 74 Fed. Supp. 427; *Ex parte Sifford* (D. C. S. D. Ohio, 1857), 22 Fed. Cas. 105, Case No. 12,848. While the above list is by no means complete

it presents a representative cross-section of the cases and completely establishes the long and continued adherence to "The Rule" on the basis of "comity."

Consider then the nature of the basis of "The Rule." Comity has been defined as a willingness to grant a privilege, not as a matter of right, but out of deference and good will. *Dow v. Lillie*, 26 N. D. 513, 144 N. W. 1082; *Cox v. Terminal Railroad Assn. of St. Louis*, 331 Mo. 910, 55 S. W. 2d 685. At its best it is a nebulous concept based upon judicial courtesy and accommodation while at its worst it becomes a judicial catchall subject to many abuses and which has moved at least one authority to comment:

"The term 'comity,' as already pointed out, is open to the charge of implying that the judge, when he applies foreign law to a particular case, does so as a matter of caprice or favor.' It is rather a scapegoat, an opportunity of escape for the court."

Conklin et al. v. United States Shipbuilding Co.

(C. C. D. Me., 1903), 123 Fed. 913.

Comity, as a basis for compatible administration of our dual judicial system is undoubtedly above reproach when, as in the cases above cited in support of "The Rule," it is similarly interpreted and obeyed by both sovereigns. When they cooperate there is no need to go further than the rule of comity in working out any differences which may arise. But what is to be done when as appellant so succinctly puts it, there is "a rude clash between jurisdictions" and one sovereign acts in a manner inconsistent with the principles of this nebulous concept of "comity." Since comity is based upon a form of judicial etiquette are sanctions available to compel obedience to "The Rule" or is the sovereign who has been denied, without remedy?

The instant case presents such a question. Under ideal conditions of comity no doubt the Court below would have in the exercise of its discretion deferred to the wishes of the state and allowed the prosecution in the State Court, or failing that, the state upon learning of appellee's federal probation would on the basis of comity voluntarily defer prosecution until such time as the federal court was through with appellee. However, while idealistically that result may be desired it is apparent that realistically it is not to be achieved here. Comity being a child of agreement, not disagreement, it is submitted that some other answer is necessary to the solving of the problems presented here.

This is not to deny however the validity of the above stated rule. It has become too deeply engrained to be doubted. The difficulty which has arisen in this case stems not from "The Rule" that the first sovereign to acquire custody of the criminal maintains jurisdiction until its remedies are exhausted. It stems rather from attempts to reconcile "The Rule" with the conceptualistic approach to the status of probation. It is the theory of conceptualism that equates the status of a Federal probationer's probation to actual institutional incarceration and concludes that a person enlarged and at relative liberty on probation, is in federal custody to the identical extent as a prisoner behind bars at Alcatraz, McNeil Island or Leavenworth.

Inasmuch as probation is a privilege given at the option of the court in hopes of rehabilitation and in lieu of an actual prison term, it is perhaps only natural to, in the words of Judge Chambers, "embrace a fiction that one who is on probation is in the custody of the law." The fiction is strengthened when it is considered that a sen-

encing court may in its discretion commit a convict to prison or enlarge him upon probation for up to five years. However, fictions which appeal to logic in the situation for which they are developed can, by being extended beyond the intendments of their original, reach illogical conclusions. At that point, to quote the dissent in the instant case:

“When that fiction produces unseemly judicial conflict as this does, the fiction ought to give way. One can be subject to a court’s orders without being in the full ‘custody of the law’ without having a protective casing of ‘immunity.’”

Prior to 1925 there was no provision for probation in the Federal Courts. On March 4th of that year the President signed Public Law 596 of the Sixty-eighth Congress (Senate bill 1042) which was captioned:

“An act to provide for the establishment of a probation system in the United States Courts, except in the District of Columbia.”

See 43 Stats. 1259, Chap. 521.

Of significance is the first paragraph of Section 1 of the Act which in pertinent portion provides:

“ . . . That the courts of the United States having original jurisdiction of criminal actions, except in the District of Columbia, when it shall appear to the satisfaction of the Court that *the ends of justice and the best interests of the public*, as well as the defendant, will be subserved thereby, shall have power, after conviction . . . for any crime . . . not punishable by death or life imprisonment, to suspend the imposition . . . of sentence and to place the defendant upon probation for such period and upon such terms and conditions as they may deem best . . .” [Emphasis added.]

In its present form this enactment is contained in Title 18, U. S. C. A., Section 3651.

It is apparent from the wording of the Act that it was designed to accomplish its purpose of rehabilitating the defendant only when the ends of justice and the best interests of the public would be served thereby. It was certainly never meant to defeat justice nor to work to the detriment of the public. Yet, in the present strained construction which is forced upon us by attempts to reconcile the conception that a probationer is in the full custody of the court, with "The Rule" that the first sovereign to acquire custody of a defendant can exhaust its remedies to the exclusion of other sovereigns, we have a situation where not only is justice in danger of being thwarted but the public weal is threatened as well. It is all too apparent that in construing these two concepts together in the instant case that appellant is correct when he accuses the majority opinion of creating "ambulatory enclaves." If one on federal probation is to be removed, by reason of his probationary status, from state regulation there is indeed a cloak or shield of immunity surrounding each and every probationer, State as well as Federal, which renders them immune from any prosecution save by the permission of their sentencing courts. The instant case bears witness to the fact that such permission is not always readily forthcoming.

In this conflict between the well established rule of acquisition of jurisdiction, and the conceptualistic fiction of probation constituting custody, it is the fiction which must yield. The United States submits that there is nothing in the concept of probation which would render a probationer, who violates the law of another sovereign, immune from apprehension, prosecution and incarceration.

tion by the second sovereign. To hold otherwise would be to grant to one on probation preferred status in relation to law enforcement, superior to that possessed by the great majority of citizens who, having committed no crime, are subject to the laws, regulations and prohibitions of both sovereigns. If Federal probationers are, like appellee, immune to State prosecutions without permission of the sentencing court they are for practical purposes immune not only to felony prosecutions but also misdemeanor prosecutions. Carried to this illogical extreme a probationer may ignore state vehicle laws, sanitary laws and local ordinances. Nor is it any answer to say that at the end of his probation he would be available for prosecution since the importance of the offense may not be such as to normally withstand a lengthy deferral in prosecution. Thus, the avowed intention of the probation law to rehabilitate offenders to useful citizens is defeated by the very operation of the law. The estate of probation should not be perverted into ark of refuge for the unlawful. In the language of the Court in *United States v. Toman* (D. C., N. D. Ill., E. D., 1938), 23 Fed. Supp. 119, 121:

“To paraphrase language used in *Poniz v. Fessenden*, 258 U. S. 254, 264, 42 S. Ct. 309, 312, 66 L. Ed. 607, 22 A. L. R. 87, the probation order should not now be used as a sanctuary or as a means of conferring immunity from the laws of the state of Illinois.”

The United States therefore respectfully submits that this Honorable Court should declare that the fiction that a probationer is in the full custody of the law should give way in this instance. While one on probation is undoubtedly subject to the orders and control of certain

officers of the sentencing court, it certainly follows that the control over him is not as complete nor the regulation as strict as is the case with one actually held in physical custody. A requirement to report monthly to a probation officer does not restrain the individual to the same extent as actual confinement behind bars. It is submitted that actual physical custody of the person is requisite for the operation of "The Rule." When the sovereign first acquiring custody of the person relinquishes actual physical custody of the probationer, it subordinates its rights to rehabilitate the probationer to the rights of the second sovereign to compel obedience to its laws.

The views expressed above as to the status of a probationer, are not without precedent.

In *United States v. Bradford* (2d Cir., 1952), 194 F. 2d 197, in denying Bradford, a probationer, the right to invoke Title 28, U. S. C. A., Section 2255, because probation was not custody, Judge Hand stated at page 200:

"We have no occasion to express any opinion as to that; for Bradford was not 'in custody' of any sort whatsoever . . ."

In *United States v. Binion* (D. C. Nev., 1952), 13 F. R. D. 238, Judge Yankwich said at page 242:

"There are cases which hold that while a person is under probation he is in the custody of the court which granted probation and that a prosecution by a state court during that period would be unauthorized. *Grant v. Guernsey*, 10 Cir., 1933, 63 F. 2d 163; *Dillingham v. United States*, 5 Cir., 1935, 76 F. 2d 35; *United States ex rel. Hall v. McGowan*, 1948, D. C. Minn., 80 F. Supp. 792; *United States*

ex rel. Speece v. Toman, 1938, D. C. Ill., 23 F. Supp. 119.

“I am unwilling to extend the doctrine of these cases to Federal proceedings for as a defendant might be guilty of distinct offenses in several districts, the government should not be prevented from instituting multiple prosecutions merely because a prosecution in one district has resulted in a probationary sentence.”

A recognition of the problem here presented, and a significant suggestion for its solution is found in the case of *United States v. Schurman* (D. C. S. D. N. Y., 1949), 84 Fed. Supp. 411, viz.:

“Finally, petitioner appears to contend that upon his original federal conviction on May 31, 1946, the court lacked power to try him because he was then a state parolee, and lacked power to sentence him or to admit him to probation for 22 months concurrently with his New York parole. Apparently, petitioner asserts that one on parole or probation is in the constructive custody of the paroling or probationing authority, and that one cannot be in the control of two sovereign authorities at the same time. *cf.* *Grant v. Guernsey*, 10 Cir. 1933, 63 F. 2d 163, certiorari denied, 1933, 289 U. S. 744, 53 S. Ct. 688, 77 L. Ed. 1491.

“Accepting that premise, it might follow that petitioner’s violation of federal probation was the violation of a void judgment and no offense, that his conviction and sentence for such violation was void and should be vacated, and that petitioner will not have to complete service of that sentence upon his prospective release from New York custody. The first leg of petitioner’s argument, that the court lacked power

to try him while he was a New York parolee, rests on the conceptualistic motion that such a trial would invade the constructive custody of the New York authorities. The same argument has been rejected where the state's custody is actual and not constructive. State prisoners, actually confined in a state jail have been tried in federal courts. *Lunsford v. Hudspeth*, *Wall v. Hudspeth*, *supra*, *cf.* *Ponzi v. Fessenden*, *supra*.

"Conceptualism is satisfied in that situation by finding an implied consent on the part of the state authorities to the limitation, suspension or cessation of their custody as the circumstances indicate. *Zerbst v. McPike*, 5 Cir. 1938, 97 F. 2d 253.

"Where the defendant is a state prisoner, consent is found in his physical surrender to federal authorities. Where the defendant is a state parolee, consent must be found in the state's granting the parole, and in its failure to object to federal custody. To hold otherwise would be to create an intolerable and most dangerous situation whereunder the considerable number of state parolees would be at large but immune to federal prosecution and punishment for the violation of federal law. Federal-state comity would not be furthered by such practice. Moreover the same reasoning would also clothe federal parolees with immunity against state prosecution for the vastly greater number of offenses known to state law. No such incredible purposes were intended to be served by the humane provisions of the probation and parole statutes. Once we accept the conclusion that a federal court may incarcerate a state parolee, *a fortiori* it should be able to admit him to probation. *Grant v. Guernsey supra*, is inconsistent with these views; I must respectfully differ."

It is the position of the Government that "The Rule" that the first sovereign having possession of a person may exhaust its remedies against him to the exclusion of other sovereigns applies only where there is actual physical possession and custody. Once the first sovereign enlarges the person on probation it looses the requisite degree of custody and control, and inferentially consents to the assumption of jurisdiction by any other sovereign entitled thereto.

This position accords with that line of cases, cited in the majority opinion herein, to the effect that actual physical custody of a prisoner insuring his presence before a court having jurisdiction of the subject matter gives that court jurisdiction over the accused.

Kerr v. Illinois (1886), 119 U. S. 436;

Mahon v. Justice (1888), 127 U. S. 700;

Pettibone v. Nichols (1906), 203 U. S. 192;

Moyer v. Nichols (1906), 203 U. S. 211;

In re Johnson (1897), 167 U. S. 120.

It is clear that actual physical possession and custody of the prisoner is requisite to attain personal jurisdiction. It is submitted that in the instant case it is likewise requisite to *maintain* jurisdiction to the exclusion of a second sovereign desiring to prosecute.

Nor does this position in any way contravene those Supreme Court cases which established "The Rule" on priority of jurisdiction. That line of cases started with *Ableman v. Booth* (1858), 62 U. S. 506 (*supra*) and included *Ponzi v. Fessenden* (1922), 258 U. S. 254. Thus by 1922 "The Rule" had been evolved by the Supreme Court. Application of the rule by Circuit and District

Courts since that time has been in reliance on the authority established by those cases. However, the evolution of "The Rule" took place during a period when the actual physical custody over the contested person was not in dispute, for at the time those cases were determined there was no provision by which Federal Courts could place a convict on probation, thus invariably the person involved was actually incarcerated by one of the sovereigns and the matter of actual physical custody thus was not open to serious question. For instance: in *Ableman v. Booth* (*supra*), Booth was held in the physical custody of the United States Marshal first on a commissioner's commitment and then by judgment of the District Court; in *Tarbles* case (*supra*), Tarble was held in the physical custody of one Lieutenant Stone of the United States Army; in *Robb v. Connolly* (*supra*), the accused was physically held in California by an officer of the State of Oregon; in *In re Johnson* (*supra*), Johnson was held in physical custody by one United States Marshal in defiance of another; and, in *Ponzi v. Fessenden* (*supra*), the accused was imprisoned in the state workhouse on a federal commitment.

In 1925, three years after *Ponzi v. Fessenden* (*supra*), the Probation Act was passed (March 4, 1925, Public Law No. 596, Sixty-Eighth Congress 43 Stats. 1259, *supra*). By this Act the Federal courts were given the power to suspend a sentence and enlarge the convicted person on probation. While various courts, unthinkingly perhaps, persisted in applying "The Rule" when the convict was on probation and not imprisoned, it is obvious that such action ignores a vital distinction in degrees of custody and extends the operation of "The Rule" to a

status never contemplated by the Supreme Court in the formulation of "The Rule". When a criminal is safely incarcerated any conflict between sovereigns as to priority of punishment is largely academic as far as the public is concerned because no matter which sovereign prevails the criminal will be punished (usually imprisoned). In that event the first sovereign having actual physical custody of the criminal can, by reason of the absolute control inherent in, incarceration safely exhaust its remedies against him without endangering the public. In such case the wisdom of "The Rule" of the exclusiveness of first acquired jurisdiction is apparent. If the second sovereign desires to punish the criminal it can do so either by "borrowing" him for purposes of prosecution or by waiting till the expiration of his term of *imprisonment*. In neither case does the public suffer since at all times the criminal is in the absolute custody and control of one of the sovereigns.

A different situation obtains where the first sovereign seeks to exercise its remedies by putting the criminal upon probation. Even though the fiction of custody be indulged it is evident that the safety which inures to the public when the criminal is in jail does not prevail when he is free, to roam the streets. Requiring him to report monthly or semi-monthly to a probation officer, while technically a control of sorts, does not guarantee to the second sovereign and the citizenry at large, that degree of protection which imprisonment assures. By its act of exposing the second sovereign to future depredations of the probationer, the first sovereign subordinates its interest in the rehabilitation of the probationer to the interest of the second sovereign in protecting the public and vindicating its laws. There is no immunity, there can be no immunity.

III.

Examples.

Both in Judge Chamber's initial dissenting opinion and in the memorandum of the United States filed in support of the petition for rehearing *en banc*, certain questions were raised as to the operation of the law under the majority opinion. It is submitted that a complete answer to said questions is presented by adoption of the contention of the *amicus curiae* that a person enlarged upon probation is not in that degree of custody of the sentencing court as will warrant it in maintaining jurisdiction to the exclusion of a second jurisdiction desiring to prosecute—in short, that federal probation carries no cloak of immunity from state prosecutions and vice versa. These questions are briefly considered.

(a)

Q. "Suppose a state probationer violates the federal kidnapping statute. The Federal Bureau of Investigation finds the kidnapper. Can its officers arrest the culprit? Must they get the permission of a state judge to arrest him? If they can arrest him but must get permission to prosecute, how long can they hold the kidnapper while they wait for permission? If the judge who hears the habeas corpus decides the other jurisdiction should prosecute, then may the prisoner appeal claiming an abuse of discretion?"

(First dissenting opinion 233 F. 2d 598, 608.)

If, as the United States claims, probation confers no immunity from prosecution the Federal Bureau of Investigation could arrest the kidnapper even as they could arrest any nonprobationer for the same crime. Since the state had subordinated its rights to rehabilitation by putting the kidnapper on probation, it would not be necessary to get the permission of the state to arrest him or

to prosecute him once personal jurisdiction (or custody) was secured. Since the probationing jurisdiction (state in the example) has rights inferior to the arresting jurisdiction (federal), no decision would be made regarding the forum of prosecution. The prisoner would be arraigned and tried in the arresting jurisdiction and there would be no right to appeal not available to any other prisoner.

(b)

Q. "Can a juvenile state probationer go out, rob a national bank, get caught by the Federal Bureau of Investigation, and then taunt his arrestor with 'You can't arrest me. You can't prosecute me. My juvenile judge said you couldn't touch me.'"

(First dissenting opinion 233 F. 2d 598, 609.)

The taunt might be made but since the juvenile judge has, under the theory here advanced, by placing the juvenile on probation, made the juvenile subject to the law enforcement of the other sovereign equally with the large majority of the citizenry, no objection could be interposed by the juvenile judge or the state to federal prosecution for violation of the bank robbery statute.

(c)

Q. "Will we deny the great writ [habeas corpus] to one who commits the state offense after he goes on federal probation but grant it if his state offense precedes his federal offense in point of time?"

(First dissenting opinion 233 F. 2d 598, 609.)

This question admittedly presents a logical distinction which cannot be overlooked. It can be persuasively argued that even assuming the validity of the argument herein advanced, for crimes committed by the probationer sub-

sequent to his release on probation, crimes against the second sovereign committed prior to the probation order could well be held to be considered by the probationing judge at the time he made the order. It is submitted that the probationing judge should not in logic consider accusations of former unproved crimes at the time he grants probation.

A person under consideration for probation who is accused of committing prior unproven crimes, should, under the presumption of innocence, be entitled to have the determination of his probation made without reference to such claimed crimes.

To attempt to draw a distinction on the basis of the priority of crimes would, in the words of the dissent, truly be, "a bucket of eels." It is, therefore, submitted that in the interests of the administration of criminal justice, no distinction be drawn between crimes against the second sovereign committed prior to or subsequent to the order of probation. There being no immunity in probation, the probationer in either case should be susceptible to apprehension, prosecution and incarceration subsequent to the probation order.

(d)

Q. "Suppose the federal probation is in San Diego and the subsequent state offense and arrest are in Alameda County, California, in the Northern District of California. The application for habeas corpus must be made in the United States District Court for the Northern District. How will that work? Will a judge of the federal court in the Northern District exercise the Southern District's . . . discretion as to whether state prosecution should go ahead?"

(First dissent 233 F. 2d 598, 609.)

Under the theory propounded here, the only exercise of discretion by the probationing court occurs at the time it elects to admit the defendant on probation. By this act, as has been stated above, the court loses the requisite degree of custody over the probationer to allow it to object to prosecution by another sovereign having jurisdiction. The interest of the probationing sovereign must then recede before the interest the second sovereign has in enforcement of its laws and protection of its citizens. Accordingly, the second sovereign (the state in this example) would have jurisdiction to try and imprison the probationer. Jurisdiction being present habeas corpus would not lie and since the interest of the probationing sovereign is inferior to that of the prosecuting sovereign, there would be no discretion in the courts of the probationing sovereign to decide which sovereign should prosecute. That question would have been decided by virtue of the above, and the second sovereign's possession of the probationer.

(e)

Q. "Whether the jurisdiction of the second sovereign to detain and try a probationer of the first sovereign prevails in absence of express assent by the first sovereign?"

(Second dissent 235 F. 2d 756, 759.)

If the second sovereign has gained personal jurisdiction or possession over a probationer of the first sovereign, it possesses a right to vindicate its laws in protection of its citizenry which is superior to the right of the first sovereign to rehabilitate the probationer. Therefore, the jurisdiction of the second sovereign to try a probationer of the first sovereign not only prevails in absence of the express assent by the first sovereign but prevails even in the face of an objection by the first sovereign.

(f)

Q. "Whether probation from the first sovereign completely insulates the probationer from prosecution by subsequent sovereigns during the term of his probation?"

(Second dissent 235 F. 2d 756, 760.)

This question is, of course, basic to the theory expressed herein by the United States. In conformance with the views hereinabove expressed, it can only be reiterated that probation carries with it no insulation from apprehension, prosecution, and imprisonment by subsequent sovereigns.

(g)

Q. "Whether a person on probation is to be considered in the custody of the law for all purposes?"

(Second dissent 235 F. 2d 756, 760.)

This aspect of the case has been discussed at length above. In recapitulation it can be said that custody or the absence of it is not all black nor all white. There are varying shades of gray. While the conceptualistic theory gives rise to the legal fiction that one on probation from a court is "in custody" to the same extent as one in prison by order of court, such is obviously not the case. Control and regulation, quite real where the person is imprisoned, are, in the case of a probationer, likewise legal fictions. A person held in physical confinement has the requisite "custody" to test his confinement by habeas corpus. A person enlarged upon probation does not. *United States v. Bradford* (2d Cir., 1951), 194 F. 2d 197, *supra*.

The conclusion is inescapable that while from a theoretical standpoint we may speak of "custody" as regards one on probation, from a practical standpoint the degree

of custody can differ vastly. A man walking the street on probation is not in the same degree of custody as a man held in an isolation cell at Alcatraz. The fictional custody of probation is not of the sort contemplated by the Supreme Court during the development of "The Rule."

Conclusion.

It is a well established rule that between sovereigns asserting criminal jurisdiction over a person, the first sovereign to attain custody (and hence personal jurisdiction) of the person retains the right to exhaust its remedies against that person even to the exclusion of other sovereigns who attempt to intervene. This rule is not jurisdictional but is based on comity and is the keystone to the operation of compatible state-federal criminal justice. This rule evolved in this country during the last century and, since probation was unknown to the federal system during that period, contemplated only cases where the person was in actual physical custody. In 1925, the probation act came into force, thus allowing federal courts the option of incarcerating a convict or admitting him to probation. Since an incarcerated convict was *in custodia legis* from the court which sentenced him, the conceptualistic view gave rise to the legal fiction that a probationer was likewise in the custody of the law. The conflict in this case springs from the attempt to reconcile the rule on priority of jurisdiction with the legal fiction that one on probation is in the full custody of the law. If the fiction is valid a probationer is surrounded by a cloak of immunity to prosecution by a second sovereign save with the permission of the first sovereign. It is the position of the government that this result is wrong and is dangerous. Where the result reached by the fiction is unseemly, the fiction must give way. Accordingly, it

is urged that by granting probation a court impliedly consents to necessary prosecutions by a second sovereign whose laws the probationer violates. Since the first sovereign can no longer control the actions of the probationer, its interest in his rehabilitation is subordinate to the interest of the second sovereign in vindicating its laws and protecting its citizenry. Therefore, the degree of custody the probationing sovereign has over the probationer is not sufficient to enable it to invoke the rule of comity and prohibit apprehension, prosecution and incarceration of the probationer by a second sovereign. This is true whether the offense against the second sovereign is committed prior or subsequent to the probation order.

Grant v. Guernsey (10th Cir., 1933), 63 F. 2d 163, a leading case on identical facts is inconsistent with these views, and it is the position of the United States that it should be disapproved by this honorable court.

In view of the premises, the instant case should be reversed.

Respectfully submitted,

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United States
COURT OF APPEALS
for the Ninth Circuit

ALBERT A. ARVIDSON, et al., *Appellants*,

vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.

W. J. WHITEAKER, et al., *Appellants*,

vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.

APPELLANTS' BRIEF

*Appeals from Final Judgments of the District Court for the
Western District of Washington, Southern Division.*

HON. GEORGE H. BOLDT, Judge.

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United States
COURT OF APPEALS
for the Ninth Circuit

ALBERT A. ARVIDSON, et al.,
Appellants,
vs.

REYNOLDS METALS COMPANY, a corporation,
Appellee.

W. J. WHITEAKER, et al.,
Appellants,
vs.

REYNOLDS METALS COMPANY, a corporation,
Appellee.

APPELLANTS' BRIEF

*Appeals from Final Judgments of the District Court for
the Western District of Washington, Southern Division.*

HON. GEORGE H. BOLDT, Judge.

JURISDICTION

Jurisdiction of the actions in the district court properly attached because the complaints (I-2, 118)* alleged

*Figures in parentheses in this brief denote corresponding volume and page references in the nine volume Transcript of Record.

ed diversity of citizenship and amount in controversy under 28 U.S.C.A. §1332.

Final judgments in the cases were entered December 30, 1954 (I-103, 209), and appeals were filed January 28, 1955 (I-105, 211). The appeals having been taken in time (I-106, 211) under Rule 73(a), F.R.C.P., this Court has jurisdiction of the appeals under 28 U.S.C.A. §1291. By order of this Court dated February 24, 1955, the cases were consolidated for appeal purposes.

STATEMENT OF THE CASES

In December, 1950 (I-84), the *Arvidson* appellants filed their complaint in the Western District of Washington, Southern Division. The *Whiteaker* appellants filed theirs in that Court in November, 1952 (I-84). The actions were tried together. The *Arvidson* action was concerned with appellee's Troutdale, Oregon aluminum reduction plant and the *Whiteaker* action was concerned with appellee's Longview, Washington aluminum reduction plant. Paragraph V of each complaint (I-4, 120) alleged that appellee deposited particulates (i.e., solids) on appellants' real properties all located in Washington. By reason of such deposit, appellants claimed damage to their real properties and to the personal properties located thereon.

Because of Paragraph V, we think appellants in both cases pleaded (and later proved) a trespass as distinguished from trespass on the case as to their real properties. By reason of such pleading and because of what we think is the applicable subdivision of the Washington

statute of limitations, we believe appellants were entitled to prove damages to their real properties starting at a date three years prior to filing their complaints. Since the statute referred to deals with trespass and the limiting period therein is three years, we think it applies to these cases.

As to their personal properties, we think appellants were also entitled to the benefit of the Washington three year statute of limitations. This is so, we believe, not because appellants pleaded a trespass as to personalty, but because of a distinct personalty subdivision of the three year Washington limitations statute specifically covering " . . . taking, detaining or injuring personal property . . . " whatever may have been the theory of the complaints as to personalty.

Whether appellants pleaded or proved a trespass as to their real properties was a legal question which was ruled on by the trial court in a number of ways both before and after the trial. What limitations period was involved was one of those rulings. The trial court also considered and ruled before and after trial whether appellants were entitled to the Washington three year statute as to personalty. We have delayed detailed consideration of these rulings for the body of this brief because analysis here would unduly prolong this Statement. It seems enough to say here that the orders and findings on limitations and on trespass adverse to appellants present the principal questions involved on these appeals.

At the close of this Statement we shall summarize the questions involved and the manner in which they

arose. Rule 18(2)(c), this Court. A brief digression at this point, however, to discuss two important "factual" bases for the trial court's written decision and ultimate finding of non-liability is believed required to assist this Court in understanding the issues. (The complete text of the decision is reproduced in the Transcript beginning at I-84; it is reported in 125 F. Supp. 481). One of these "factual" bases has no support in fact at all; and the other has very little.

The "factual" base which has no support in fact at all is the trial court's reliance upon what it thought were the results in similar cases in the Pacific Northwest. The Court said in its decision:

"In a number of cases previously heard in this and other courts in this area awards for fluoride damage resulting from operation of the Troutdale and Longview plants have been allowed, but every such case involved periods when little, if any, fume control measures were taken and before the installation of the later of the fume control improvements referred to." (I-87)

According to this quotation, the unique feature of the present cases is that for the first time a court in the Pacific Northwest was confronted with fluoride claims involving periods of time after installation of the "later of the fume control improvements" at the Troutdale and Longview plants. As the trial court (I-86) noted, the "later improvements" at Troutdale were completed in November 1950 and at Longview in 1949. The exact dates are Troutdale, November 3, 1950 (I-25) and Longview, May 14, 1949 (I-151).

The fact is that of the four flouride cases tried in Pacific Northwest federal courts, one involved operations of the Troutdale plant *after* November 3, 1950 and one involved operations of the Longview plant *after* May 14, 1949. In both cases liability was found and damages awarded. One of the remaining two cases involved Aluminum Company of America and the other involved the Troutdale plant before November 3, 1950.

The Troutdale case involving a claim for damages after November 3, 1950, was *Paul Martin and Verla Martin v. Reynolds Metals Company*, Civil No. 6151 (D. Ore.). Trial of that case began December 8, 1952, before the then Chief Judge of the Oregon District, James Alger Fee, sitting without a jury. Judge Fee signed his findings and conclusions as Circuit Judge December 18, 1954. Additional finding No. III read as follows:

"III. The amount of damage sustained by the plaintiffs with respect to their lands aforesaid and cattle operations thereon for the period from the commencement of operation of the Troutdale plant on September 23, 1946, by the defendant, up to the date of the filing of the complaint in this action on the 22nd day of August, 1951, is the sum of \$47,-135.00."

Additional finding No. V read as follows:

"V. During May of the year 1951, the plaintiffs placed upon their said lands a test herd of healthy young cows, calves and bulls, approximately 30 in number, and prior to and at the time of the trial of this action some of the animals in said test herd unmistakably showed evidence of having ingested more than a normal amount of flourine, and two of the animals slaughtered the day of the trial commenced unmistakably showed flourosis and had

toxic quantities of flourine in their bones and tissues."

As just noted, the "later improvements" at Troutdale were completed November 3, 1950. Obviously the above two findings, particularly Finding No. V, can mean only that defendant in the *Martin* case was causing damage in 1951. In fact, Finding No. V goes further and means defendant was causing damage in 1952 up to the time of trial December 8, 1952.

The Longview case involving a claim for damages after May 14, 1949, is *John M. Thorup and Kate W. Thorup v. Reynolds Metals Company*, Civil No. 5884 (D. Ore.) also tried before Judge Fee without a jury beginning August 25, 1952. Finding No. XIX signed by Judge Fee in that case on January 9, 1953, read as follows:

"XIX. Fluorides emanating from defendant's aluminum reduction plant in the period January 5, 1945 to August 25, 1952, did settle upon plaintiffs' real property in amounts sufficient to cause and did cause injury and damage to the dairy animals which grazed on the vegetation growing there. Said fluorides caused damage to plaintiffs in the amount of \$14,241.26."

Finding XIX thus covers a damage period over three years after May 14, 1949.

To summarize, the *Martin* and *Thorup* findings mean defendant (appellee here) was causing damage at both plants not only after the "later improvements" at each, but late in the year 1952. Trial of the cases at bar began November 4, 1953 (I-102-A, 208-A).

We regret that Judge Fee's opinions in the *Martin* and *Thorup* cases are not reported. We also regret having to quote from the findings in those cases since they are not in the Record on Appeal in the cases at bar. However, they were not before the trial court either, and we feel we must correct the impression created by the trial court's decision that the cases at bar presented for the first time a claim of fluoride damage after completion of the "later improvements" at the Troutdale and Longview plants. In this connection, appellee's counsel in the cases at bar were also counsel in the *Martin* and *Thorup* cases.

The "factual" basis for the trial court's decision and ultimate finding of non-liability which has little support in fact is the following extract from the Court's decision:

" * * * Almost every plaintiff on cross examination was badly discredited in various respects but primarily by (a) testimony at the trial directly contrary to testimony given by pretrial deposition; (b) reluctant admission of conditions and causes unrelated to flourine accounting in many instances for the damage or condition complained of; (c) admission of substantial increases in income from dairy products during the years complained of as contrasted to earlier periods when flouride effluence was as much or greater; and (d) the testimony of some plaintiffs in the Arvidson case that no injurious effects or damage were observed from 1942 to 1945 during the period Alcoa was operating the Troutdale plant without the fume control improvements installed by defendant when flouride effluence must have been very much greater than during the period complained of. It would appear from the testimony last referred to that the cattle injury and loss of milk production complained of were either

not due in any material degree to flourine or were the result of an accumulation of flourine deposits in forage over a period including several years prior to the limitation period. In this connection it should be noted that the experts produced by plaintiffs testified that flourine deposits on forage dissapate [sic] rapidly and do not accumulate over any great length of time particularly in areas subject to frequent rainfall." (I-89-90)

The generalizations involved in (a), (b) and (c) of the above extract are obviously vital on the issue of credibility, a matter of course, peculiarly within the province of the trial court. Despite the generalizations, the actual facts with respect to the *Whiteaker* case are as to: (a) all four plaintiffs testified and their depositions were not even used at the trial; (b) no plaintiff admitted anything except the usual incidence of disease (except Mr. Josephson who readily stated he had a Bangs disease problem in 1952 (VI-1427), and each claimed fluorides as the effective cause of his troubles; and (c) no plaintiff admitted receiving more income in years complained of as compared with earlier periods (see Sec. III of this brief conclusively showing that milk production decreased as fluorides increased and vice versa). In short, the generalizations involved in (a), (b) and (c) of the above extract do not apply to the *Whiteaker* case at all, a fact not noted in the extract itself. As the extract shows, (d) does not apply to the *Whiteaker* case.

As to the *Arvidson* case, all thirteen plaintiffs testified at the trial. Concerning (a) the cross-examiner did not use one plaintiff's deposition while examining him (Albert Arvidson); depositions were used in cross-ex-

amining six plaintiffs (Depoe, Seekins, Ford, Robson, Ray Arvidson and Norelius), but nothing was said in any way contradicting the deposition testimony; and while four plaintiffs, Brandt, Stauffer, Isbister, Baker) were contradicted at the trial on the basis of what they said on their depositions, these contradictions were on very minor matters indeed. Thus Mr. Baker in the two years between the time he was testifying and the time his deposition was taken, changed his mind as to whether he was claiming that his land had been depreciated (IV-680); Mr. Brandt in two years forgot he testified on his deposition he had sold four animals for lack of hay (V-946); Mr. Isbister was uncertain after a two year delay whether his 1950 production was normal (IV-493) and whether his cow Pansy was a normal producer in 1951 (IV-495); and Mr. Stauffer said at the trial that he had misunderstood a deposition question asked two years earlier when he answered it by saying that an annual cull of seven or eight cows in a herd of twenty-five would be normal; he thought the deposition question was intended to find out what he was in fact culling (IV-640).

Concerning (b) in *Arvidson*, plaintiffs, as in the *Whiteaker* case, readily admitted the usual incidence of disease in the years complained of and claimed fluorides as the effective cause of their troubles.

Concerning (c) in *Arvidson*, three plaintiffs only admitted receiving more income in years complained of as compared with earlier years. Mr. Hester was one, but

he explained on cross-examination that the increase was due to his having fed hay not raised on his farm:

“Q. Isn’t it a fair statement that your milk production while you were at Washougal gradually increased from the standpoint of total pounds of butter fat produced?

A. Yes, after I started feeding straight Golden-dale alfalfa it did increase. In fact, it always did in the winter when I started feeding alfalfa hay, it would increase.” (IV-392)

Mr. Robson also received more income, but solely because, as he testified (V-902-3), he started selling higher-priced Grade A milk for the first time during the years complained of. While Mr. Ford thought his 1948 income was higher than his 1949 income, he was slightly mistaken. The 1948 figure was \$11,526.90 and the 1949 figure was \$13,160.32 (IV-743)

The extract’s (d) applies only to *Arvidson*. We agree (last sentence of (d)) that experts testified that fluorine does not accumulate, but what the Court overlooked as to the rest of (d) is that, while Alcoa operated the Troutdale plant for three years, appellee had been operating (except for very brief shut downs) continuously for over seven years when the cases at bar came to trial. Moreover, there was a year’s respite from whatever had been the effect of Alcoa’s operation because for a year after Alcoa’s operation ceased, the plant did not operate at all (I-20). After that year, appellee started operating. It may well be that fluorine does not accumulate, but it seems obvious that any poison would be more effective if continuously consumed for seven years than it would if consumed for only three years.

This brings us to the questions of fact and law involved before this Court and the manner in which they arose. They are: (1) On the evidence, was appellee continuously and repeatedly depositing solids on appellants' properties within the two year periods of limitations held applicable and up to the time of trial? This question arises by virtue of Finding XXVI, *Arvidson* (I-102-C) and Finding XVI, *Whiteaker* (I-203-B). The question is referred to in our Statement of Points II (I-223. (2) Were appellants' cattle injured substantially within the same periods? This question arises by virtue of Finding XXVIII, *Arvidson* (I-102-D) and Finding XVIII, *Whiteaker* (I-208-B). The question is referred to in our Statement of Points III (I-223-4). (3) Did the trial court err in holding that (a) the claims for damages to both real and personal properties as alleged in the complaints were limited by the two-year rather than by the three-year Washington statute of limitations? and (b) the deposit of solids on Washington lands is not a trespass? Question 3 (a) arises by reason of the trial court's orders entered before trial (I-12, 138) and its Conclusion II in each case (I-102-E, 208-C) holding the two-year statute applicable. It is referred to in our statement of Points I (I-222). Question 3 (b) does not, of course, call for review of the findings, but it does involve the trial court's Conclusion IV in both cases (I-102-F, 208-D).

If the Court is satisfied that solids were deposited on appellants' properties and that, accordingly, a trespass in each case was made out, remand for further consideration of the trial court's Conclusion VII (I-102-F, 208-D) in both cases refusing judgments restraining or

controlling appellee's future operations is clearly indicated. And if the trial court applied the wrong statute of limitations and/or incorrectly determined that appellants' cattle weren't injured, remand is required for proof and/or assessment of damages.

In seeking the setting aside of certain of the trial court's findings, we are mindful of Rule 52, F.R.C.P. providing in part that ". . . Findings of fact shall not be set aside unless clearly erroneous . . ." With respect to this extract, the Supreme Court of the United States recently said in *McAllister v. United States of America*, 348 U.S. 19, 20:

" . . . A finding is clearly erroneous when 'although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' *United States v. Ore. Medical Society*, 343 U.S. 326, 339; *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 . . ."

Our specification of errors (Rule 18(2)(d) this Court) takes the form of the following "Points" which are taken up in order in this brief:

Point I

Solids were continuously and repeatedly deposited on appellants' properties within the two year period of limitations held applicable and up to the time of trial.

Point II

Appellants' cattle were injured substantially within the two year period of limitations held applicable and up to the time of trial.

Point III

The Washington law of limitations as to real and personal properties and the Washington substantive law of trespass

A. Rulings of the trial Court.

B. The Washington law of limitations and of substantive law concerning trespass to real property.

C. The Washington limitations law as to personalty.

POINT I

Solids were continuously and repeatedly deposited on appellants' properties within the two year period of limitations held applicable and up to the time of trial.

We think the common law in Washington as elsewhere is that anyone who deposits solid materials on another's real property is guilty of a trespass irrespective of damage. We shall deal with the authorities to that effect below. Here we shall show from the evidence that solids were, within the period of limitations and up to the time of trial, in fact deposited by appellee on appellants' real properties.

Mr. Zeh, appellee's chief chemist, called as an adverse witness, testified that at both the Troutdale and Longview plants five to six pounds of fluorides were consumed for every 100 pounds of aluminum produced (erroneously reported as "per ton") (III-32). He further testified that hydrogen fluoride and cryolite were

the principal escaping fluorides (III-33), and that 90% of the fluorides getting out of both plants are *solids* (III-34). As to the amounts of fluorine leaving the plants, the figures are 750 pounds a day at Troutdale (III-98) and 250 per day at Longview before expansion of capacity from 60,000,000 to 100,000,000 pounds per year (III-71) and no less than 450 per day thereafter (VII-1673, 1614).

Mr. Zeh said that appellee started testing vegetation in 1946 and air in 1949 around both plants in order to determine how much fluorine was getting out and where it went (III-37). Both plants have fume control systems (III-33) and, generally speaking, the fluorine in the samples declined as the controls were installed at both plants (III-41).

Mr. Zeh testified that normal vegetation contains 20-25 parts per million (ppm) fluorine (III-42) and that results above that range indicated airborne fluorides (III-73). This he knew because he had tested various materials outside of contaminated areas (III-73). Appellee's forage testing results near the Whiteaker place in the last four months of 1952 averaged well over Mr. Zeh's "normal" figure of 25 ppm (III-44, I-160). Those results were also well over those figures for the same four months in the three or four years prior to 1952 (I-158-160). They were also over "normal" in the spring of 1953 (I-161). When asked whether the increased fluorides were associated with appellee's increased capacity at Longview (from 60,000,000 to 100,000,000 pounds per year) which took place August 1952, he said that "good common sense" so indicated (III-47).

Appellee for some time had maintained a testing station near, but not on the Rawnsley, Josephson and Goldsmith places. Had the results been obtained on those farms instead of on the station, Mr. Zeh thought the results would have been comparable (III-66). Those results for the summer of 1953 were at or above the witness' "normal" figure of 20-25 ppm (I-172), and Mr. Zeh eliminated the possibility of a non-Reynolds source when he said, " . . . there are no other large users of fluorine in there" (III-60).

As to Troutdale, appellee maintained 13 stations on the Washington side of the Columbia. Had the results obtained been obtained on appellants' farms instead of on the stations, the results would have been comparable (III-79). Later Mr. Zeh explained that the testing stations had been selected by agreement for the trial because they bracketed the farms and that the station results obtained were comparable to results that would have been obtained on the farms if the distances between the two were reasonable (III-122). Similarly to his Longview testimony, Mr. Zeh eliminated any non-Reynolds source of fluorides at Troutdale by testifying that the only other source there was a small sawmill (III-76). Concerning the results obtained by appellee on its 13 stations (I-58-63), Mr. Zeh agreed that in 1948 and 1949 all stations were over his "normal" of 20-25 ppm at some time of the year; that all except one station was in 1950; all except four were in 1951; all except one was in 1952 (III-80); but that only six of the 13 were in 1953 (III-81). He didn't know why the 1952 results

were higher generally than those in either 1951 or 1953; but he saw no great difference statistically (III-81).

On appellee's testing results and on the admissions of this one adverse witness, it is perfectly clear that appellee is a substantial user of fluorides at its Longview and Troutdale plants; that fluorides do escape from those plants; that 90% of the escaping fluorides are in *solid* form; and that more than "normal" amounts of fluorine in *solid* form regularly year by year up to the time of trial had been deposited on appellants' farms. If the Court will carefully consider the references to Volume I of the transcript noted in the three preceding paragraphs, it will be apparent that as a matter of mathematics appellee was depositing *solids*. Thus, for example, appellee took eight samples near the Whiteaker farm in the fall of 1952 beginning in September. The results ranged from 26 to 60 ppm (I-160). Subtracting Mr. Zeh's 20-25 ppm as "normal" and applying his 90% particulates to the balance, the result establishes solids on the testing stations.

That solids arrived on the farms does not depend on this mathematical showing. There was direct and uncontradicted testimony on the subject. Dr. William E. Caldwell, a witness for appellants, is a chemist who was trained in meteorology (IV-441). He had visited the plants and explained that when the fluorides leave the plants they travel with the wind currents. The cloud containing the fluorides spreads 20% of the distance traveled (IV-444) and rises and falls 10% of the distance traveled (IV-445). The size of the escaping solids at the

two plants is sub-micron to 10 microns. At these sizes and assuming that 90% of what escapes is in a solid form and that the wind blows 4-6 miles per hour, the solids would travel with the air stream and adhere to the ground proportionately to the square of the distance from the plants (IV-448). Dr. Caldwell had previously (IV-446) testified as to average wind speeds. He concluded by saying that at two miles from the plants one-half pound per acre of fluorine would be deposited annually. At four miles the deposit would be two to three-tenths pounds per acre per year and at eight miles one-tenth pound per acre per year (IV-464-5). These fluorides, he said, would be in the form of cryolite particulates, sodium fluoride and mist particles (IV-465).

It will be noticed that the amounts mentioned by Dr. Caldwell are measures of *solids*. These amounts were elicited on cross-examination. The testimony was:

"Q. Assuming the conditions as they exist and existed at Longview when you made your visits there, how much fluorine in the form of fluorides would accumulate about two and one-half miles from the plant measuring it on an acre basis over a period of one year, if you know?

A. Are you asking if I have an opinion of the amount?

Q. Yes.

A. My answer to that is yes. Now are you asking for an estimated amount?

Q. That is right.

A. May I give background for my estimate?

Q. Well, you give me the answer; then you can give the background after.

A. My estimate is that there would be approximately a half pound per acre per year at about two miles from the plant.

Q. And what would it be at four miles?

A. It would be less at four miles, not taking square roots.

Q. An eighth of a pound, would you say? Double the distance?

A. Not taking square root mentally I would say it would be three tenths or two tenths per pound.

Q. What would you say about eight miles?

A. Progressively less with distance.

Q. Well, what would you estimate it to be?

A. I am not here taking square roots and carrying this out exactly on an arithmetical basis. I would estimate somewhere of one tenth of a pound.

Q. Per acre at eight miles?

A. Yes.

Q. What would that be, in what form, particulates?

A. It would probably be some cryolite particulates, sodium fluoride, gaseous HF which would have then been absorbed into the form of droplets, mist particles.

Q. That is eight miles away?

A. Yes." (IV-464-5)

The real properties of all appellants in both cases are well within eight miles.

The following review of other experts' testimony (all on behalf of appellants) concerning the deposit of fluorides is to some extent cumulative. Its importance additionally, however, is (a) three independent experts gave their opinions that appellee was the source of the fluorides and, (b) the same experts thought that 10-15 ppm was "normal" on pasture grasses. It will be recalled that Mr. Zeh, an interested employee of appellee, said 20-25 ppm.

Dr. Allmendinger is a highly qualified expert who is in charge of the Western Washington Experiment Station at Puyallup, Washington. He has worked on the fluorine problem since 1943 (III-127). In his opinion anything over 15 ppm fluorine on pasture grasses or gladioli represents airborne fluorides (III-142-143). His figure was 10-15 ppm on prunes. When the Troutdale plant was closed from September 1945 - September 1946, he obtained results on prunes in the summer of 1946 down to 17 ppm, while in July and August 1945 the results were 150 and 119 ppm (III-156). In 1947 the prune samples were up again to over 300 ppm (III-156). The course of his Troutdale area testing thereafter is shown by the following testimony:

"Following down through the analyses we get considerably, or I should say quite high samples during 1947 and 1948 and there is one sample 178 during 1949, but all of the samples taken there are much above that which would naturally occur in 1951 and 1952.

Q. Let me interrupt you for a moment if I may, Doctor. It is also an agreed fact in the Arvidson case as of the fall of 1950 Reynolds installed a new control system to begin operating at that time which increased the efficiency of its fluoride collection devices from the pre-existing about 62% effective to approximately 90. With that fact in mind would you proceed?

A. Well, beginning in 1951 the average of the results would be somewhat lower during 1951 and 1952 than the two samples taken in 1953. They also show somewhat lower, but still above what you would expect to occur without contamination." (III-156-7)

With respect to the agreed fact that the Longview plant was also closed for a period of time, Dr. Allmendinger was questioned and responded as follows:

"Now it is an agreed fact in this case that the Longview plant was closed between the spring of 1947 and the spring of 1948. With reference to that agreed fact would you please interpret the prune leaf results shown on this page?

A. The best place to show that is in this location marked '25th & Beech.'

Q. Where is 25th & Beech?

A. It is on the northwest side of Longview, I believe, oh approximately a couple of miles, I would say, from the aluminum plant. The fluorine analysis of these prune leaves as you will note for 1945, the two records taken there 404, 419, show considerable fluorine in the air. In fact, those are rather high readings. 7/25/46 we got a reading of 208. Then in June and September 1947 the readings were quite low. Reading in 1948 again the first reading in June is moderate and then the fluorine content increases. Through each of the following years we have picked up considerably high readings and you will notice, generally speaking, there is a trend for fluorine content of the foliage to increase from early in the spring to the fall. This is not uniform as perhaps you will get a low sample or high sample, but generally speaking there is a tendency for the fluorine to increase as the season advances in foliage.

Q. What do you conclude from that fact?

A. Well, it appeared that the, since the fluorine content was reduced during the period that the plant was out of operation and immediately started to rise again after the plant came into operation, that Reynolds was the source of the contamination involved.

Q. That is your opinion?

A. That is my opinion." (III-167-8)

Mr. Miller, a chemist and an associate of Dr. Allmendinger, did all the fluorine analyses on the project (V-209). He has also been engaged in the fluorine problem for nearly 10 years (III-210). In his view normal forage should contain not over 10 ppm fluorine and neither should gladioli (III-215-216). As to prunes, his level is 15 ppm (III-216). He agreed with Dr. Allmendinger that the extreme variation in the fluorine content of prunes between the times when the two plants were open (III-217-8) and when they were closed as shown by Exhibits 20 and 520 was attributable to appellee's operations (III-219).

Dr. Compton's experience with fluorides was similar to Dr. Allmendinger's. He has been working on the problem of airborne fluorides since 1948 (V-998). He has worked with pasture grasses, buckwheat, gladioli and has tested air for fluorine content. He is currently conducting an experiment on Sauvies Island, Oregon. His control (i.e. in a non-flourine area) stations for that experiment at Dayton, Newberg and Corvallis, Oregon show for grasses, 2 to 4.7 ppm. On his air sampling at the Troutdale airport he got a fraction of a part per billion fluorine (V-1015), while he never got any at Corvallis (V-1051). Over 10 ppm on pasture grasses indicates to him airborne fluorides (V-1013).

The most recent results obtained by appellee on the testing stations nearest the Whiteaker place as shown by pp. 13-14 of the Pre-Trial Order (I-157-161) indicated airborne fluorides to Dr. Compton as did also the 1951-53 results obtained by the Western Washington

Experiment Station on the Whiteaker place (I-163-164). As to the results obtained by appellee near, but not on the Rawnsley, Josephson and Whiteaker places (I-169-172), Dr. Compton testified as follows:

“A. For 1948 on page 18 there seems to have been quite a lot of fluorine there throughout the sampling season, and in my opinion looks like it would probably be airborne fluorine even though it is what you say, five miles away?”

Q. About five miles east southeast of the Long-view plant.

A. And the same thing would seem to apply in 1949 with the exception of that sampling on August 23rd, and in 1950 there are, starting in March 17th, values running above 10; 11 parts per million on May 19th is borderline, and I wouldn't say one way or the other whether that was airborne or not, but the others would indicate that possibly there is a little airborne fluorine in the area, at least as indicated by those samples up to the sampling of August 17th. From then on the values are about like our normals or controls indicating no, in my opinion, no atmospheric fluorine contamination from March 17th on through the sampling season.

Q. Take a look at the next page, please.

A. Well, the values run from about 3.2 parts per million up to about 41 parts per million, and only those values of 10 or above that I have any suspicion of, and I see two twelves and I wouldn't put too much weight on these because these, I assume, are single values.

Q. You may so assume. It is a single sample.

A. Yes. So the atmospheric fluoride contamination in my opinion was pretty low during that particular season at that farm except on the 18th of August (I-171) when it went up to 41 parts per million.

Q. All right. Now as to 1952, if you will?

A. Well, there are two or three high values there.

One, 106 on the 20th and 21st of August and another value of 37 on July 22nd, and a number of, well 10 and some twelves. In general there was atmospheric fluorine contamination it looks like in 1952 with the exception of those times when the values were 10 or below. Again I would not place too much importance on values running 11 and 12 because they are borderline. As I have indicated right along, they are on the borderline and again these are single values.

Q. How about 1953?

A. In 1953 the values running from 29 down to 9.5; all fairly low in my opinion. I wouldn't say there is any atmospheric contamination on first sampling which was January 28th or 29th it would indicate, nor would I be very much concerned about the samplings, the sample taken on April 29th. The others indicate there is possibly some atmospheric fluoride contamination in the area, but not too much.

Q. What would you say about the period—what would you say about the last three samples standing alone?

A. Well, they are considerably higher than any of the others or the average of the others for that season indicating a little greater atmospheric contamination for those three samplings." (V-1022-24)

Dr. Compton's views with respect to appellee's 13 testing stations bracketing the Arvidson appellants' farms are as follows:

"Q. Have you got the Arvidson pretrial order?

A. Yes.

Q. Doctor, will you take a look at page 28 and 29. Those are agreed on figures, Doctor, and they represent a sampling of forage grasses done by Reynolds, and it is agreed that the results set forth on those two pages for the years 1948—I am sorry, it is three pages, and ending on page 30 (I-58-63). It

is agreed that those results on pasture grasses upon analysis by Reynolds did contain those many parts per million. Is there anything that you want to add to the generalizations you made on the figures in the other pretrial order after looking over this bunch of figures in the Arvidson order?

A. Well, let's take it by years. The samples taken in 1948 are usually, well, with about two exceptions that I see now are all about 10 parts per million, a few elevens, but some of the values go up in the sixties and so on. For that year for those particular station samples it looks like there has been rather an appreciable amount of contamination of that pasture.

Q. I might say, as you probably already figured out Doctor, the numbers at the top of the bunch of figures indicate different testing stations.

A. Yes, I understand that, listed up above; I see. In 1949 there are a number more stations of 10 or less, but in general there has been rather appreciable atmospheric contamination as indicated by these figures for it looks like all of those stations for the months of the season that was sampled with the exception, of course, of those values running 10 or less.

Considerably less contamination in 1950 as indicated by a rather large number of values below 10. There were times when there was rather appreciable amount at some stations during that year, but by and large the contamination was very much reduced from what it was in the previous two years.

In 1951 the values are even lower it seems like than they were in 1950, although that might not be upon a little longer examination.

The last three years it looks like contamination has been materially reduced over what it was the previous two years.

Q. I wonder if I could direct your attention to 1952, Doctor, as compared to 1951 and 1953?

A. 1952 vs. the other two. Well, there seem to

be more high values, values above 10 for the latter part of 1952 than there were in 1951, and especially so at some stations. In 1953 most of the values, it looks like, are 10 or below indicating that the contamination that year was even less than it was in 1952 and possibly even in 1951. I can't tell by glancing at a sheet like this." (V-1031-33)

Mr. Zeh had testified that he averaged the fluorine results he obtained (III-58). In response to some questions by the Court, Dr. Compton had some interesting things to say about averages and also the effect of the winds upon the deposition of fluorides. The colloquy deals with the figures at the top half of p. 22, Whiteaker Pre-Trial Order (I-177-8) and was as follows:

"THE WITNESS: Well, in 1951 the average is 15.8. That would indicate for the season as a whole there has been atmospheric fluoric contamination, and the same thing would apply to 1952 for the season as a whole.

THE COURT: But only by a very small margin?

THE WITNESS: That is right, that is right, very small margin, to be sure, and of course we always have to look at what makes up an average, and in 1952 the range is from sixty-six down to two, quite a wide spread.

THE COURT: That is the biggest spread of any of those?

THE WITNESS: Yes it is. It would be dangerous, I think, to use averages. They mask the variation that we find within the season and that is always true. If we can say this average plus or minus value, that would give us some idea of the range we are working with, but when we get an average like this nineteen and you can very well see it makes quite a difference. It doesn't even approach sixty-six nor does it approach two, so that average I

would think in my opinion is very misleading. It doesn't show the picture at all.

THE COURT: One other question I have in mind and that is apparently—I don't want to anticipate, maybe you are getting to this, but I'd like to while it is in my mind.

MR. CRONAN: Very well.

THE COURT: Apparently the fluorine concentration must dissipate very rapidly or, in view of the fact that monthly, one month you have got sixty-six and the next month you have got 2. Does—is it a logical inference to draw from that that you, that the contamination disappears very rapidly or may disappear very rapidly?

THE WITNESS: Well, the contamination at the source may vary, yes, and that will vary due to wind movement. But maybe what you are getting at is what happens in the grass itself, is that it?

THE COURT: Yes, I'd like you to give me an explanation of how it comes about that you may have for example, for a period of two or three samplings you will have quite high readings and then all of a sudden you will run into a period when there will be very low readings. Now the—one would—the lay person would assume from that that the contamination rather quickly dissipates or disappears.

THE WITNESS: That is exactly right. It will depend on wind movement. If it is a steady wind for a long period of time from certain definite definite direction blowing on that farm from the source, we could expect high values. If there are periods of calm or periods when the wind has shifted in the opposite direction, then the contamination would probably be reduced to zero.

THE COURT: That is just a little different point than I had in mind, but I am glad to have that too.

The point I am getting at is that apparently if you had a high parts per million for say two or three months in a row and then supposing the

source, whatever the source might have been, was completely shut off, then right away immediately your sample would immediately go down to practically nothing and I would take it, or at least a lay man would take it from that that when the source of contamination is stopped that the contamination in the grasses and the pasture and the vegetation very quickly dissipates and disappears?

THE WITNESS: It would if that pasture were clipped off or the cattle were eating it off and new grass comes up. Grass, pasture grasses grow from the base of the leaf up, not from the top of the leaf, so that when we cut it off then new grass is coming up from below, that is, the blade is increasing from the base toward the top. The growing point, in other words, is at the base of the leaf.

THE COURT: And that happens quite rapidly?

THE WITNESS: Very rapidly, yes sir.

THE COURT: Because otherwise if you had values running at say the level of sixty in a given month and then the, well say the source of contamination is cut off, if it, that value of sixty would still remain there for some length of time afterwards except for the very rapid growth of the plant and disappearance of it, is that the explanation?

THE WITNESS: Yes, and another thing is that fluorine accumulates in the tips of the grass leaves, grass blades and we remove that when we clip it or when the cows eat it off. The new material then has to be exposed to the fluorine from wherever the source is, to get another supply." (V-1028-30)

We believe the above summary of the evidence clear-shows that appellee in both cases was continuously and repeatedly depositing solids on appellants' properties.

POINT II

Appellants' cattle were injured substantially within the two year period of limitations held applicable and up to the time of trial.

This portion of our brief is designed to show that appellants' cattle were injured substantially in fact: it is not designed to show any particular amount of damages. If this Court agrees, the amount of damages is, of course, for the trial Court on remand.

We do not think for the purpose stated it is necessary to go further than to show this Court that a representative group of appellants in each case owned cattle that appellee injured. We want to emphasize, however, that the cattle claims discussed are representative and that this portion of the brief is designed merely to show that the trial court was wrong in finding in each case and as to all claims that "Plaintiffs' cattle were not injured . . . " (I-102-D, 208-B).

The representative group of claims we have mentioned takes the following form. There are 10 dairymen and three beef operators in the *Arvidson* case (Miller withdrew). Five of the dairymen are "Grade A" shippers of milk and five are "Grade C" or "factory milk" shippers. There are four "Grade A" shippers only in the *Whiteaker* case. Two clear elements of damage suffered by the dairymen are: (1) Physical abnormalities suffered by their cows; and (2) Loss of milk production. (We do not believe it necessary to deal here with the beef operators' somewhat different types of losses for the

purpose stated). Six *Arvidson* dairymen appellants, three "Grade A" shippers and three "Grade C" shippers, and two *Whiteaker* dairymen appellants, both "Grade A" shippers have been selected for the purpose of what follows.

The proof as to the eight farms analyzed below with respect to the two elements of damage breaks down logically, we think, into: Section I, which is a rather detailed recitation of the eight farmers' complaints as testified to by them; Section II, which breaks their complaints down into six categories all of which refer to either of the two elements of damage just mentioned; Section III, dealing specifically with lost milk production; Section IV, analyzing appellants' expert testimony; and Section V, commenting on the defense made at the trial.

I. THE FARMERS' COMPLAINTS ABOUT THEIR COWS.

A. The Whiteaker Case.

1. Rawnsley

Mrs. Rawnsley testified that she and her husband had been on their present place in Kelso, Washington since 1936 and before that lived at Rose Valley, four miles from Kelso (VI-1141). They started in Rose Valley in 1932 or early 1933 and had 16 purebred Jerseys. She operated the dairy and their retail route in Rose Valley while Mr. Rawnsley worked elsewhere (VI-1142). She also oversaw the milk house work and the trucks at Kelso at first (VI-1143). They continued the retail route at Kelso until early 1945. There was no hired help in 1946 so she again worked with the cows (VI-1145).

When they first got Holsteins at Kelso, the barn had to be remodeled to accommodate the cattle because they were bigger than the Jerseys. Now the daughters and granddaughters of those Holsteins fit in the so-called Jersey string because they are that much smaller than the original Holsteins. The cattle used to move easily in the barn but now they have trouble moving sideways. There used to be very little room between the cattle in the stanchions and now there is plenty of room (VI-1146). When Mrs. Rawnsley first went back to work in the barn in 1945 she noticed the difference in the way the cattle acted and how nervous and stiff they were. When they laid down it was hard to get them on their feet (VI-1146). She had seen none of these conditions at Rose Valley (VI-1147).

On cross-examination Mrs. Rawnsley repeated that the first time she noticed the stiffness and nervousness was when she first went back to work in the barn in 1945 (VI-1148). She explained that she wouldn't know whether these conditions took place before 1945 because she wasn't around the cattle enough. There was a shortage of milk before they sold the retail route. She was then asked whether that would be prior to 1940. She at first replied "yes", but the date was later corrected to prior to 1945 (VI-1152). She also said she didn't think the milk production was normal now (VI-1152).

Mr. Rawnsley also testified that the Rose Valley operation started early in 1933 and he agreed his wife was in charge of the herd then. The Kelso start was May 1, 1936 (VI-1158). They kept up the milk route

until the end of January, 1945 (VI-1159), and had 63 stanchions filled most of the time. They milked anywhere from 60 to 110 or 115 (VI-1160). He testified the present ranch will carry 62 to 63 mature cows, plus their replacements (VI-1161). Mr. Rawnsley said the first time he noticed anything unusual was the summer of 1942 when he lost some springer cows. He never noticed any stiffness until about 1945, but then had trouble getting the cows up to the barn (VI-1163). He did some doctoring for hoof rot, but the animals were never lame in the same foot twice so it was something else (VI-1164). Upon examination of one cow he could find no lesions in the hooves and so decided she was lame in the joints (VI-1164). Mr. Rawnsley explained that he had treated cattle for what he knew to be foot rot and used blue vitriol which cured it. When he tried the blue vitriol in 1945 it had no effect (VI-1165). Mr. Rawnsley said that after the war he built up the herd to fill his 63 stanchions but he couldn't hold the production (VI-1165). The cows got thin and stiffness seemed to become more prevalent. Their milking periods got shorter, *but when he moved out of the place in the spring of 1948 because of the flood the production went back up.* When they got back to his place a few of them seemed to snap out of it and they lost the long hair and the stiffness (VI-1166). He really began to get worried about the cows along in 1950. Some cows he had bought in the fall of 1949 made good records one year but when they started their second lactations most of them were " . . . just out of the picture" (VI-1166). They scoured (diarrhea) on pasture and scoured on silage. He would

take them off silage and they'd be all right in three or four days (VI-1166). He also brought in some mature cows in 1950 and they seemed to have no resistance to whatever factor was bothering them (VI-1166). Returning to the flood conditions, he said that at that time he moved the herd to the Cunningham place which is a mile north of Castle Rock, Washington, May 24, 1948. It was there until late in June. He then brought the cattle back to his place and dry-lotted them on eastern Washington hay (VI-1168) on a little piece of ground that was not under water (VI-1167). His own place was covered with water until August 25, 1948. He raised no feed on the place in the summer of 1948 and bought his winter feed that following winter. That feed came from eastern Washington (VI-1169). He was able to raise hay and silage the following year in 1949 (VI-1169). The animals were next on pasture at his place April 1, 1949. They were on pasture all of 1949 and the succeeding years down to date (VI-1169).

The most serious condition in the herd after 1950, Mr. Rawnsley believed, was the loss in size. ". . . it has got to the point where a good many of the three-year olds weigh under a thousand pounds and I don't believe there has been a normal size animal raised on the farm that was born after 1948" (VI-1170). Mr. Rawnsley illustrated this with some weight slips which show that one heifer of his weighed 800 pounds at 30 months. Another was 22 months old and weighed 710. The proper weight, he said, for one just under two years is about 1050 or 1075 and, as to one 30 months old, it should be 1100 or a little more (VI-1173). He then produced seven

slips for cows weighed at three years old which should average 1250 and which did weight a lot less (Ex. 600-D-1-A).

Mr. Rawnsley then testified about some animals that were scouring badly in October 1952. Normally he doesn't have scours in October (VI-1177). The scours, he said, build up during periods of wind from the west and winds a little north of west (his farm is $4\frac{3}{4}$ miles east-southeast of appellee's plant, I-174-5) and the critical periods seem to come during the times of heavy air before a storm. He gets relief from the scours with a heavy rain. After a heavy rain the scours clear up within two or three days (VI-1177). Fifty per cent of the herd was scouring in October, 1952. He had intermittent scours during November but not as badly as in October. When he has scouring there is a loss of milk production (VI-1178). The cows dropped off in milk pretty badly in October, 1952 and thereafter took "... a terrific drop" (VI-1179).

Mr. Rawnsley then identified some production charts he had prepared from his D.H.I.A. book (a production testing association record) which illustrated short lactations (VI-1182). As to one chart that shows six lactations he explained that this is an unusual picture because, for example, the cow went up to a high peak of 80 pounds on the second month on one lactation so that one could expect 750 pounds of butterfat whereas she actually did 432 (VI-1185). He defined mature equivalent to the effect that one should get 70% of normal out of a two-year old first calf heifer. Applying that to the

six lactations on the charted cow he was just talking about, the picture is definitely wrong (VI-1186). Mr. Rawnsley illustrated the point with another charted animal (VI-1187). Exhibit 600-D-18-B illustrated generally, he thought, his point that his animals milk less on the second and third lactations than they do when the first freshen (VI-1189). Mr. Rawnsley also testified that a normal production curve should go up to within five or six pounds of the peak the first 30 days, peak on the second 30 days, level off at about 90, and then gradually start to drop very little for about two months. That would be normal (VI-1190). He believes his charts illustrate that he can peak the animal at two months but can't hold her; moreover, it doesn't make any difference what feeding schedule he follows; it just can't be done (VI-1191). When asked whether he feeds consistently with a normal production curve, he said that every animal in the herd gets the opportunity until there isn't a possible doubt that she is not going to make the expectancy (VI-1191).

Mr. Rawnsley believes the animals are stiff and not lame; he distinguished by saying that the animals seem to be peglegged in all four legs and hurt in the joints (VI-1192). He further complained that they have long hair, are thin, have short milking periods and are getting smaller from generation to generation. There is also a change in the teeth. Animals normally shed their winter coats by the 1st of May, Mr. Rawnsley said (VI-1192). However, he has had animals up until August that still have red, dead hair on them. This has been true in other years but is more prevalent now (VI-1193). Mr. Rawns-

ley also noticed a little lapping of water back in 1944 and quite a bit in the winter of 1945. He solved that problem by heating the water up about 10 degrees. This cuts down the lapping a whole lot (VI-1196). He still has this a little on individual cows, but not too much now.

Mr. Rawnsley next showed some slides illustrating scours after June 15, 1953, on a three-year old heifer (VI-1205). He had wet heavy air in the morning at that time. The situation reached its climax June 20th and the milk dropped down 25% (VI-1206-7). He then showed some pictures of slab-sided cows, including one that was very skinny in June and later died (VI-1207), together with two pictures of animals that he identified as being 300 pounds light (VI-1208). He also had pictures showing absence of scours, which condition obtained in the latter part of June and early July, 1953 (VI-1209). Some pictures of some calves in very poor condition were exhibited (VI-1209). He lost eight out of 10 of them. He also showed a picture of a three-year old that weighed only 55% of normal and is undersize (VI-1211), and a picture of a five-year old taken June 15, 1953, which was definitely undersized and underdeveloped (VI-1212). He contrasted these with a picture of a normal animal taken for comparison purposes. He pointed out that this animal was slick as the others should be (VI-1213). He finally showed some March, 1953, pictures when there was no scouring; and also some pictures of the animals showing non-scouring when Reynolds' veterinarians were at his place in October, 1953 (VI-1219).

When asked on cross-examination whether scours is something that concerns dairymen quite often, Mr. Rawnsley said, "Not this type" (VI-1224). The last time he had scours different from the one he was complaining about was about 1940 (VI-1224). He attributes the scours to grass contamination he gets when the wind comes from appellee's plant (VI-1225). In June, 1953, he had scours when his cattle were on pasture. *The kind of mastitis he has had in the last five years is mechanical caused by injury to cows that are stiff and cannot handle themselves.* The other two types are bacterial. Mastitis will cause a drop in production but production will not go up before the drop (VI-1228). The condition of rough, red hair he also attributed to the forage which was consumed by his animals. Mr. Rawnsley said that his production from 1936 to 1941 was good (VI-1230). He was a member of the D.H.I.A. during part of that period, but his records during that period were lost in the flood. During the war years when he was not a member production decreased because of fluorine and Bangs disease. He agreed that possibly the decrease was due to some extent to the fact that he wasn't testing in the war years, so he didn't have an adequate basis for culling and that this had some bearing on the lost production during that time (VI-1231). D.H.I.A. testing, he concluded, will help a dairyman regardless of his condition (VI-1235).

Mr. Rawnsley repeated on cross-examination that when the animals went off his place because of the flood, they were gone from May 23, 1948, until late in June

(VI-1240), and that when they came back, they were dry-lotted on purchased feed. He also said again that he had no feed of his own until he got spring pasture, probably in April, 1949.

Mr. Rawnsley believed that one individual associated with Washington State College advised him that the urine analyses would have to show in excess of 10 ppm in order to be toxic to cows or cause damage. When some October 1952 samples were taken, the range was 2.9 to 10.4 ppm but he had no fluorine at that particular time (VI-1245). While he attributed the October, 1952, scours to fluorine, there were no scours at the time the urine samples were taken (VI-1246). He believed the scours broke out early in October and again late in October, and also pretty well through November, 1952. The urine samples were taken October 12 and October 17, 1952. As he recalls, there was little scours in the middle of October. Sometimes the scours don't last 24 hours (VI-1246). Longest period that the entire herd had had scours has been a couple of weeks. He agreed he testified on direct examination that 50% of the herd scoured in October and continued intermittently into November (VI-1247). History of the scours was that he had heavy scours early in October and a week or two with very few scours; then some more in the last few days of the month and pretty heavy in November (VI-1248).

Mr. Rawnsley was also asked on cross-examination about the two calves which were considerably underweight. He said they were not eating their bedding, but if they were, it would not signify they were not getting

enough feed; that is just a habit of animals (VI-1253). It is not unusual (VI-1254).

On redirect examination Mr. Rawnsley said again that the hay he fed after the flood came from eastern Washington and that when he went on pasture the next year the season started in April, 1949, because the seedings were new (VI-1254).

2. Whiteaker

Mr. Whiteaker said that he acquired his present place in January, 1948, and moved there in August, 1948 (VI-1464). Before that he lived in the town of Kalama, Washington, about 10 miles southeast of the Longview plant. He had had some troubles in Kalama during the period he operated there from 1942 to 1948. He had some stiffness " . . . and one of the worst things . . . was the lapping of water" (VI-1466). Nevertheless, he thought it was all right to move to his present place in January, 1948 because the plant was then closed and Mr. Shoemaker (the Longview plant manager) said it wasn't going to reopen (VI-1466). He brought a group of heifers to the present place in the spring of 1948. He built a home there and so did his brother (VI-1467). He moved into his house August, 1948 and his brother moved into his house November, 1948. They first had some milking cows there the latter part of June, 1948, 28 or 29 head. They were flooded out in the spring of 1948 (VI-1468), and the cattle were moved out to a place half a mile away from the old place. Later on, in the pasture season of 1948, they were brought back to

a rented place right next to appellee's plant (VI-1469). The animals wintered there until April 1949. No feed was grown on their own place in 1948. The animals came back to the present place April, 1949, and have been there ever since (VI-1470).

Answering a question as to how his animals produced *before they got to the present area, how they produced on the rented pasture and how they produced afterwards*, he said that one cow made 429 pounds at Kalama in 1946, 472 in 1947, and in 1948 she died after 65 days production with 97 pounds of fat. Another did 494 at McMinnville, Oregon, and in 1947 at Kalama 644. For the year ending 4/20/49 she did 396 (VI-1479). Another Chehalis, Washington, cow did 448 in 1946, 372 in 1947, and 347 in 1948. Another did 403 in 1946, 443 in 1947, and 285 in 1948. On a Canadian cow he made 370 in 1947, and in 1948, 205. Another cow did 328 in 1946, 325 in 1947, and 312 in 1948. *His herd average May 1, 1947, to April 30, 1948, was 373.9 pounds of butterfat when the plant was closed, and it has never been that high since.* They have about the same feeding practices ever since they have been on the present place except that in the year 1948-49 they had no silage and raised no home grown stuff in that year (VI-1482).

As to condition, the cattle have had long hair for the last three or four years. They have not been poor in flesh except beginning in October, 1952, at a time when the wind was coming from the southeast (VI-1487). The farm is $2\frac{1}{4}$ miles northwest of appellee's plant (I-152). In October, 1952, they also had a very bad outbreak of

scours—the worst they ever had. The milk production went down with the scours (VI-1487). The herd average October 1952 was 28.3 pounds butterfat and November was 21. The scours hit about half the herd. It persisted until they had a heavy rain (VI-1488). The rain came in the late fall. They have had lots of stiffness in the cattle. The animals walk slowly; when they come in the barn they stand and shift from one foot to the other. This condition they have had since the fall of 1948. In this last year it has steadily been getting worse. *All these conditions have been worse beginning in the fall of 1952* (VI-1490). Production has been low and is steadily getting worse and the animals are getting smaller generation by generation. A three-year old Jersey in good condition, Mr. Whiteaker said, weighs about 900 pounds (VI-1491). Of the 60 cows they have, six or seven of them are three-year Jerseys and they'll average between 600 and 700 pounds (VI-1491). The two-year olds weigh 400 to 500 pounds and should weigh 600 anyway (VI-1492). The four-year olds are less than 900 and should be between 900 and 1000 (VI-1492). *The two-year olds are the worst* (VI-1492). The animals are not filling out as to frame as well as weight being down (VI-1492). While they have some Holsteins they have never raised any, and so Mr. Whiteaker could not compare them for size (VI-1493).

On cross-examination Mr. Whiteaker repeated that while they had had scouring before October, 1952, that was the worst they had ever had. It came in the first part of October, 1952.

As to his culling, Mr. Whiteaker said there has been no period when he didn't sell many animals or didn't sell at all. Animals have been sold consistently (VI-1502). He thinks Susan is the only animal still in the herd that was there in 1948 (VI-1504).

Mr. Whiteaker testified further on cross-examination that they purchased quite a few cattle from the outside in 1951 and those animals were in the herd for about a half a year as far as that particular testing year goes. Those purchases were started in October of 1951 (VI-1506, 7).

They had some milk fever in 1950 or 1951 and called in either Dr. Guard or Dr. Norman. They don't have very much milk fever; not more than average. They had some in 1952 and 1953 (VI-1507). He knew what acetonemia is, and it is counteracted by glucose shots. They had none this year; one last year and one or two in 1951, and also a few cases of hoof rot. There was no more trouble with mastitis than average (VI-1508).

B. The Arvidson Case.

1. Hester

Mrs. Hester testified that she and her husband had been living in Aurora, Oregon, since September, 1951 (IV-337) and that they lived in Washougal, Washington, before that, beginning June, 1947 (IV-338). The Washougal place is $4\frac{1}{2}$ miles northeast of appellee's Troutdale, Oregon plant (I-36). They had some Bangs trouble in Aurora in April, 1952 (IV-340). When the Bangs hit them, the milk cows averaged six to seven

years of age. They got rid of the Bangs cattle (IV-340), and the average age of herd in the fall of 1953 was four years (IV-341). She testified on cross-examination that they had had no Bangs trouble at Washougal.

Mr. Hester testified that he now (1953) has three clean Bangs tests in a row (IV-352). He went on to say that at Washougal the animals didn't hold up in flesh as well as they should have and that he had had a lot of trouble with lameness (IV-369). The feet of the cattle swelled up at Washougal (IV-370). Dr. Keller (his veterinarian) gave intravenous shots which did not cure the lameness but did get them out of pain (IV-370). Mr. Hester felt that on the production they made at Washougal they should not have gone down much in flesh (IV-370). The animals were sort of rough at Washougal and didn't lose their winter pelts as they should have (IV-371). He tried blue vitriol to stop the lameness at Washougal (IV-371). This is ordinarily used for infections but it didn't do any good (IV-372). The animals are now (1953) in good condition and at Aurora are getting better (IV-372). They milk a lot better now than they did at Washougal (IV-373), even though the average age of the herd is now between four and five and was between six and seven before they got rid of the Bangs cattle (IV-373). He still has seven of the Washougal cows (IV-373). They are better in flesh and in their milking now (IV-374). But they are not in as good condition as the other Aurora cows (IV-374).

On cross-examination Mr. Hester said the animals were in fair condition when he purchased them in Wash-

ougal (IV-375). But they were not in really good condition (IV-375), and he did not make a close physical examination of the animals before buying them (IV-376). He merely watched a couple of milkings (IV-376). At the time of his purchase they were in pretty good shape (IV-377) but he had a lot of lameness the following July; that is, 1948, and had not observed it up to that time (IV-377). By the summer of 1952 following the move to Aurora, Oregon, the animals improved quite a lot (IV-378).

Mr. Hester further testified on cross-examination that he did not purchase much Goldendale hay the first winter he was there (IV-380). During the winter of 1949-50, his third winter there, he fed Goldendale alfalfa exclusively and no locally grown hay (IV-382). No locally grown hay was fed in the winter of 1950-51 either (IV-382). He agreed that he testified on his deposition that in the winters of 1949-50 and 1950-51 he fed straight purchased Goldendale hay (IV-383). The Goldendale hay purchases the first two winters were in an insignificant amount (IV-385). On the hay Mr. Hester concluded that a little bit of locally grown hay was fed in the winters of 1949-50 and 1950-51 (IV-389).

Mr. Hester agreed that on the average during the Washougal years he was milking about 20 cows (IV-390). When asked on cross-examination whether his milk production didn't gradually increase at Washougal, he said: "Yes, after I started feeding straight Goldendale alfalfa it did increase. In fact, it always did in the winter when I started feeding alfalfa hay it would increase"

(IV-392). When asked whether the herd wasn't a pretty high producing herd for a grade herd because it was pretty close to 300 pounds B.F., he said he wouldn't call that a high producing herd but he would call one at 350 to 400 a high producing herd (IV-394).

On redirect examination, it was brought out that Mr. Hester's veterinarian fees as shown by his tax return for 1947 were \$53.83; for 1948, \$116.90; 1949, \$123.60; 1950, \$179.50 (IV-405). He agreed that his testimony as to the Goldendale hay is that he fed small amounts of it the first two winters he was in Washougal and fed it exclusively the last two winters (IV-407).

On recross, he did not recall how much veterinarian fees he paid in 1952 at Aurora (IV-414). A veterinarian was there once in a while during 1952 for a milk fever and in 1953, once for a nail infection (IV-414). The cattle now at Aurora are in pretty good flesh, he said (IV-415).

2. Isbister

Mr. Isbister said he had gotten rid of some cattle on account of a little stiffness and soreness in the front legs (IV-479). He ships such cattle as soon as he can (IV-479). *The soreness is on the back part of the front foot* (IV-479). He had had the scours once (IV-480). He started with one and went through the whole herd (IV-480). This is different from spring scours, he said, because they get thin and they also go down in milk (IV-480). Speaking generally of the last four or five years, his milk production has not been what he expected (IV-481); *that is, they milk all right for a couple of months*

and then fall away. He finds his cows have been drying up in anywhere from two to six months (IV-481). He didn't notice this particularly until lately, by which he meant the last several years. As to his sales of cattle, he identified one in 1952 and another in 1951 because they fell off in production, and two more in 1951 because they got lame (IV-483). He then identified another sale in 1950 because she got lame (IV-483). Mr. Isbister said he raises two or three heifer calves every year (IV-485).

On cross-examination, Mr. Isbister said he first experienced low production in the herd about 1947 (IV-488). He identified Pol and Flo as having been sold on account of lameness in 1951 and said they were stiff quite a while before they were sold (IV-488). The first stiffness he saw in the animals was about 1949 (IV-489). In 1947 he first noticed the milk production loss although he admitted it could have been earlier and could have been later (IV-489). His production this year has been not too good (IV-490). He thought his production in 1951 was about the same as 1952 and 1953 but he hadn't checked up (IV-490). His production for those three years has been not too good (IV-490). His production in 1949 and 1950 was about the same as the other three years (IV-491). He agreed that he testified in his deposition that 1948 and 1949 were his bad years, although what was read from the deposition was that that was right as far as he could tell (IV-493). He agreed that his testimony now is that the production for 1952 and 1953 was the same as for 1950 and 1951 (IV-493).

Testifying about particular animals, Mr. Isbister said he sold Pansy in 1952 because she was a poor producer

and had been all the time (IV-494). She was not stiff and did not limp (IV-495). He said he sold Flo because she was sort of lame (IV-496), but corrected the name to Pol. Flo was sold because she got stiff and wasn't much of a milker (IV-497). He still has an animal by the name of Lena whose production is fair (IV-499). He agreed that Lena was said in his deposition to be a good producer (IV-500). Dolly is and has been a good producer (IV-500), but this, he explained, is only by comparison with some of the others (IV-501). Jean dries up too soon (IV-501), and this has been progressive (IV-501). Her production is not normal this year (1953) (IV-502). Joan is a little thin but otherwise is in good condition (IV-503). Lily and Dot are all right in condition and production (IV-505). Joy is a little rough and a little thin but she milks well for a couple of months and then goes down to six pounds per milking (IV-505). Bonnie wasn't ever much of a producer but she always stayed in good shape (IV-507).

On redirect Mr. Isbister said he thought the herd production from the time of his deposition to date has been below normal according to the way he feeds and takes care of his cattle (IV-512).

3. Seekins

During the last four or five years Mr. Seekins has noticed some stiffness in his animals and he has had scouring through the herd (IV-527). He has had that off and on during the pasture season (IV-528). He has had scouring on the pasture season *other than in the spring* (IV-528). Three of his animals out of seven at the pres-

ent time show some stiffness (IV-528). He has noticed that the stiff cows are the last ones to come in for feed (IV-529). His animals are not milking as well as they should (IV-529). The younger cows will hold up better for the length of their lactations than the older ones (IV-530). The cows hold up pretty well in milk irrespective of age for the first part of their lactations but they drop off quickly (IV-530).

On cross-examination Mr. Seekins said he had a family cow before 1947 but first got into the milk business at that time (IV-540). He said it's hard to answer a question whether the herd production has been about the same since 1948 although the older cows have a tendency to drop production (IV-550). Two nine-year olds and one eleven-year old are those he identified as having a tendency to drop production (IV-550). He thinks that his average production has gone down some since 1948 (IV-551). When a portion of his deposition was read to him where he said his production was about 310 or 320 B.F., he testified that, if that is interpreted to mean what the production actually was, he misunderstood the question (IV-553). What he meant was what the level should be (IV-553).

Mr. Seekins agreed on cross-examination that a cow he purchased in 1952 near Orchards did not do well even in the first year he had her (IV-560). He also identified one that he purchased in 1948 for \$190.00 as being sold in the same year for \$250.00. Nothing was wrong with her at the time of sale (IV-561). Spot is still in the herd and is doing well and in good condition (IV-562). A couple of Holsteins identified at the time of his deposi-

tion are still in the herd and they are in good condition (IV-562).

On redirect he said again that at the time of his deposition he was trying to estimate what his production should have been (IV-564). As to the drop of production in Beauty, Lady and Susie, *the loss was caused by short lactations rather than a low rate of production during a normal lactation* (IV-565). *Lady is practically dry now although she freshened in February or March.* Susie freshened in April and is giving some milk at the present time. He has had trouble rebreeding Beauty (IV-566).

4. Depoe

Mrs. Depoe testified that the Depoe dairy operation started in the fall of 1945 and continued until March, 1952 (IV-568). After March, 1952, they had crossbreds on the place and the production of milk then went to raising calves.

Mr. Depoe testified that between the fall of 1947 and March, 1952, the cattle were thin, had swollen legs and were tender-footed (IV-583). These conditions got worse and they wouldn't eat alfalfa or grain along in 1949 (IV-584). On the spring pasture in 1950 three of the cows were in such bad shape that they *could not graze in a clover field*. " . . . They just staggered out there in the field and lay down. Whenever I got them out there they'd lay right down and feed just as far as they could reach" (IV-584). He kept them for a couple of months and then shipped them to the yards (IV-584). Mr. Depoe identified these animals from his sales slips (IV-

585). His worst trouble was in 1949 and 1950, though he has had trouble ever since. Some of them look badly right now; the others are in pretty good shape (IV-585). His cattle have had trouble drinking water which they lap like a dog (IV-586). He still has that problem though he doesn't notice it so much in the beef stock which he now has (IV-586). Earlier, when he had milk cows, some of the cows hardly gave enough milk for a calf (IV-587). He bought and sold a lot of cattle trying to keep up milk production. They didn't hold weight; seemed to be thin and were unusually rough looking (IV-587). They shed late in the spring. The stiffness he had seemed to be in the knees and feet. The cattle would stagger from the stiffness (IV-588).

On cross-examination Mr. Depoe identified *Molly*, *Midge* and *Jane* as the three animals he had so much trouble with in the spring of 1950 (IV-592). Others he sold because of the fact they were not milking right (IV-593). He identified a couple of animals he sold because of mastitis and agreed that another that was 10 at the time of sale was a fairly old cow. He did not sell cows ordinarily for milking purposes. He could recall only one so sold. They usually weren't producing well enough to sell for milk production (IV-598). He recalled testifying on his deposition that a couple of animals were sold because of other trouble (IV-601). He recalled that *Belle* and *Queen* were sold because of mastitis (IV-602). The worst trouble he had with lameness and stiffness was in 1949 but he thought he had some in 1948 too (IV-604). Mr. Depoe said he pastured only his young stock on some rented property (IV-606) which is 10

miles west and little north of his place (IV-606). As to Milly, Midge and Jane, *he did not think they were on the rented property in 1948 and 1949* (IV-607). Dr. Phelps advised him to feed those three animals cod liver oil and minerals, which he did (IV-607), but did not get much change (IV-608).

On redirect, Mr. Depoe said he thought the amount of mastitis he had between the fall of 1945 and the spring of 1952 was about normal if not less (IV-612). A cow named Lazy did all right on her first calf; not so well on the second, and on the third calf she isn't doing anything (IV-612).

5. Stauffer

Mr. Stauffer testified *he has been a dairyman for 40 years* (IV-617) and has been on his present farm since 1937 (IV-617).

Mr. Stauffer said that after milking about three months his cows begin to drop off (IV-626). He raises seven to ten heifers per year (IV-626) and even that number is not enough to keep the herd going at this time. He had to get rid of some cows that weren't producing (IV-627). In addition to lack of production, he had to get rid of some because they were lame and stiff from the knee down and their feet would be puffed up a little (IV-627). He also said that when the animals drink water it takes them quite a while to get started (IV-628).

On cross-examination Mr. Stauffer said that the lameness and stiffness in his herd started about 1948 or

1949 and at that time his cows began to drop in production. He thought the drop in production occurred before he noticed the lameness (IV-629). He also thought he had sold more animals to the yards than he would have to sell normally (IV-639). *Three would be a normal cull for a herd of 24* (IV-640). When asked whether he recalled testifying on his deposition that he would expect to cull seven or eight out of 25 under normal circumstances, he replied that he does that now but would not in a normal herd (IV-640).

6. Baker

Mr. Baker testified he has averaged 26 to 30 cows in his herd (IV-671). He also said that he had had to sell " . . . an awful lot of cows" (IV-673). They were sold because they got lame and low in production and because they got stiff and sore (IV-674). When the cattle are turned out of the stanchions it seemed to Mr. Baker that their legs hurt and they just stood there (IV-674). Mr. Baker said that sometimes they just lick water when it is cold (IV-675). He raises six to eight heifers per year and buys some (IV-675).

When asked on cross-examination whether his milk production per animal hasn't been the same since 1947, Mr. Baker said he thought it was down a little in 1949 or 1950. He agreed it is back up some since then (IV-683). He didn't know how far down the production went in 1949 and 1950 (IV-683).

On redirect Mr. Baker said he has had a Bangs test every year so that on 150 individual test he has had only two reactors (IV-696).

II THE FARMERS' COMPLAINTS ABOUT THEIR COWS BY CATEGORIES.

Section I above shows clearly that the difficulties encountered and testified to by the farmers individually were essentially the same. The complaints of the eight farmers underlines the striking fact that the principal differences are ones of degree and not of kind. Moreover, as we point out below (Sec. III (b)), *whatever the difficulties were, they were alleviated when the cows got away from fluorides and got worse as the fluorides increased*. Section I above summarizes in detail what eight farmers complained about. We shall now group the complaints into categories in an attempt to point up the farmers' complaints in summary fashion.

1. Short Lactations.

Mr. Rawnsley described a normal lactation in detail:

"Q. Could you illustrate for the Court—that is, this document, now could you illustrate for the Court what a normal production curve for ten months looks like?

A. Well, a normal production curve as I see it, should go up within just a point, as a point of illustration, maybe five, six pounds of the peak the first 30 days and then possibly go to its peak the second 30 days, level off, maybe the same at 90 days, and then gradually start to drop very little for possibly two months, and then the curve would be gradual the balance of the curve. That would be normal.

Q. Gradually take the tapering off so that the curve is finished at 10 months, is that it?

A. That is right." (VI-1190)

Mr. Rawnsley produced charts he had constructed from his D.H.I.A. records on individual cows to illustrate

his testimony that his herd did not perform in accordance with his definition of a normal lactation (VI-1182, 1185).

Mr. Isbister corroborated Mr. Rawnsley. Mr. Isbister complained of low production. He attributed the low production to short lactations in the following language:

“Q. In speaking generally in the last four or five years, Mr. Isbister, would you say the milk production of your herd has been about what you expected or otherwise?

A. No, they don't seem to hold up like I would like them to.

Q. What do you mean by 'hold up'?

A. Well, they will milk good for two months and fall away and then milk good for six months and then fall away.

Q. How long does a cow ordinarily milk?

A. Well, I usually milk them about 10 months altogether.

Q. You found, however, that your cows had been drying up in anywheres from two to six months?

A. That is right.

Q. Has that been a condition that has been noticeable at any particular time, or what?

A. I didn't notice it until lately. Of course, when you sell milk you notice more than when you wasn't selling milk.

Q. Well now, what do you mean by lately?

A. Last several years.

Q. Last several years, did you say?

A. Yes.” (IV-481)

Mr. Seekins also expressly complained of short lactations. He said his younger cows milk longer than the older ones and that they all hold up well for the first part of their lactations (IV-530). He said his trouble,

so far as milk production was concerned, was caused by short lactations rather than a low rate of production during normal lactations and he identified some short milkers by name (IV-565). Mr. Depoe said that the real reason he shipped cattle to the yards is that they weren't milking right (IV-593), and Mr. Stauffer said that his cows begin to drop off after milking about three months (IV-626).

2. *Low Production.*

As we have just seen, five of the eight farmers, in complaining of low production, specifically complained of short lactations. The other three did not specifically mention short lactations, but did complain of low production (*Whiteaker*, VI-1490; *Hester*, IV-373; *Baker*, IV-674). We relate below milk flow of fluorine intake (Sec. III (b)).

3. *Stiffness and Lameness.*

All eight farmers complained of stiffness and lameness, the only difference being one of degree. Mrs. Rawnsley had operated the family dairy in Rose Valley long before appellee started operating at Longview (VI-1142). In 1945 she first came into close contact with the cows again. She then noticed how stiff the cattle were and that they were hard to get on their feet (VI-1146). This had not happened at Rose Valley (VI-1147). Mr. Rawnsley also noticed the stiffness (VI-1192) which disappeared when the cattle were taken away during the flood (VI-1166).

Mr. Whiteaker had some stiffness at Kalama, 10 miles from appellee's plant. Since the fall of 1948 the

animals walk slowly and shift from one foot to the other in the barn. Since the fall of 1952 these conditions have gotten worse (VI-1490).

Mr. Hester had a lot of trouble with lameness at Washougal (IV-369) which got better when he moved to Aurora, Oregon (away from appellee's Troutdale plant) (IV-372). Mr. Isbister encountered stiffness and soreness on the back part of the front feet (IV-479) and he identified by name certain animals so affected (IV-496, 497). Three of Mr. Seekins' seven present animals show some stiffness (IV-528) and he has noticed that the stiff animals are the last ones to come in for feed (IV-529).

Mr. Depoe in 1950 had three animals in such bad shape that they would stagger into a clover field, lie down, and graze as far as they could reach (IV-584). The animals were also stiff in 1948 and 1949. Mr. Stauffer had some stiff and lame cows with puffed up feet (IV-627), as did Mr. Baker (IV-674).

4. *Scouring.*

Mr. Rawnsley reported serious scouring (diarrhea) conditions. He brought in some new cows in the fall of 1949. They made good records at first, but in 1950 they scoured on pasture and scoured on silage. When he took them off the silage, they improved in three or four days (VI-1166). As to the herd generally, it scoured badly (50%) in October, 1952, and in June, 1953 (VI-1177, 1206-7). On the June, 1953, scouring, milk production dropped 25% (VI-1206-7). He gets the scouring in per-

iods of heavy air from the direction of the Reynolds plant and it stops with heavy rain (VI-1177). On cross-examination Mr. Rawnsley said, "not this type", when asked whether scours didn't often concern dairymen (VI-1224).

The worst scouring the Whiteakers had ever had was in October, 1952 (VI-1487). It hit half the herd, production went down about 20%, and it persisted till they had a heavy rain. They had had scouring before (VI-1496).

Mr. Isbister said the scouring he had encountered was different from ordinary spring scours because his cattle got thin and dropped off in milk (IV-480). Mr. Seekins had had scouring in the pasture season other than in the spring (IV-528).

5. *Excess Culling.*

This is so clearly tied to Mr. Ross' testimony as to what a normal cull should be that the subject is dealt with as a part of the analysis of the Ross testimony in Section IV below.

6. *Miscellaneous.*

Several of the farmers reported that their cattle had trouble drinking cold water (*Rawnsley*, VI-1196; *Whiteaker*, VI-1466; *Depoe*, IV-586; *Stauffer*, IV-628; *Baker*, IV-675). Mr. Rawnsley still has the problem, but he has cut it down considerably by heating the water about 10 degrees (VI-1196). Failure to shed winter coats was a prominent feature of the farmers' testimony too

(*Rawnsley*, VI-1193; *Whiteaker*, VI-1487; *Hester*, IV-371; *Depoe*, IV-587-8). Messrs, Rawnsley and Hester reported that this condition improved when their cattle got away from fluorides (*Rawnsley*, VI-166; *Hester*, IV-372).

Mrs. Rawnsley reported that the cattle are smaller than they used to be (VI-1146). Her husband produced some weight slips (Ex. 600-D-1-A) to support his testimony (VI-1173) to the effect that his cattle were over 30% short in weight. He felt this was the most serious condition in the herd after 1950 (VI-1170). He showed a picture of a three-year old that he thought weighed only 55% of normal and was undersized (VI-1211). Mr. Whiteaker reported the same condition both as to weight and size and said the two-year olds are the worst (VI-1491-2). Mr. Hester's cattle didn't hold up in flesh while in Washougal (IV-369, 370) but they are all right in Aurora, Oregon (IV-372). The Isbister cows got thin (IV-480), as did Mr. Depoe's (IV-583, 587).

III THE LOSS OF MILK PRODUCTION AND THE EVIDENCE THEREOF.

(a) A Summary Statement of the Milk Loss

As to the *Whiteaker* case, the Rawnsley and Whiteaker D.H.I.A. herd books were included in the Record on Appeal, respectively as Exhibits 600-C and 650-C. These books show production *actually attained*, fluorine or no fluorine. Experts, whose testimony is analyzed below, stated what the *production should have been under normal conditions*. The Rawnsley testing year is December

1 to November 30th, and the Whiteaker testing year is May 1 to April 30. With this background the following tables are self-explanatory.

Rawnsley

Year Ending in	Normal Production	Actual Production	Loss per Cow	Cow Number	Actual Loss in Lbs. B.F.
1948		364.7		42.3	
1949		430.3		38.67	
1950		411.5		37.76	
1951	430*	374.8	55.2	29.92	1651.5
1952	467.5	381.1	86.4	30.58	2642.1
1953	485	354.2	130.8	38.08	4980.8
TOTAL B.F. LOSS					9274.5

Whiteaker

Year Ending in	Normal Production	Actual Production	Loss per Cow	Cow Number	Actual Loss in Lbs. B.F.
1946		345.2		21.41	
1947		357.0		27.1	
1948		373.9		28.2	
1949		317.0		28.56	
1950		311.9		31.42	
1951	400*	307.0	93.	43.54	4049.2
1952	400	335.7	64.3	51.42	3306.3
1953	400	303.5	96.5	56.33	5435.8
TOTAL B.F. LOSS					12791.3

*The Rawnsley test year starts about the time of year that the complaint was filed, so the Rawnsley loss has been computed for the purpose of these tables to include the two years prior to filing; that is, starting 12/1/50. The loss is then continued through the year after the filing and up to trial. The Whiteakers' test year begins about six months prior to the filing date and their loss is figured beginning with their test year starting May 1, 1950. This is not quite accurate since the statute of limitations was held applicable prior to November, 1950. It is however, believed sufficiently accurate for purposes of this brief.

The loss of butterfat for the three years based on the above tables is for Rawnsley about 9300 pounds and for Whiteaker about 12,800 pounds. The milk vouchers for the two farms were included in the Record on Appeal (600-A, 650-A). They show that Rawnsley's actual butterfat sales ranged from \$1.35 to \$1.42 per pound within the period of limitations prior to filing, held applicable, and down to the start of the trial. Similarly, Whiteakers' price range was from \$1.32 to \$1.46.

We wish the Court to note particularly from the above tables that, if one measures the Rawnsley-Whiteaker loss solely by the difference between what they actually produced in their highest years (Rawnsley, 1949, Whiteaker, 1948) and what they actually produced thereafter, in other words, even if one disregards the expert testimony completely, the loss is still considerable. As detailed in the first two paragraphs of Sec. III (b) below, those highest actual years are the years in which the herds got the least fluorine.

As to the *Arvidson* case, Messrs. Hester, Stauffer and Baker are "Grade A" shippers, and Messrs. Isbister, Seekins and Depoe are "Grade C" or "factory milk" shippers. Milk slips and a record of the number of cows, butterfat produced and price received for all six of these appellants were included in the Record (the "A" and "C" series of exhibits as to each; see, for example, Hester—180-A, 180-C, I-222, II-vii). These documents show the amount of butterfat actually shipped each year within the period of limitations, prior to filing, held applicable, and down to the start of the trial. Based on the difference between what Mr. Ross (appellants' cattle

expert) said these appellants' cattle would produce under normal conditions and what they did produce, Mr. Hester has lost over 10,400 pounds B.F. in a period when his actual sales produced between \$1.01 and \$1.29 per pound. Mr. Stauffer has lost over 8,200 pounds and his price range was \$1.13 to \$1.41. Mr. Baker's loss in pounds is over 17,600 and his price range was \$1.11 to \$1.41. Mr. Isbister lost nearly 2,900 pounds at prices between 66 cents and 91 cents. Mr. Seekins' poundage loss was over 2,500 and his price range was 70 cents to 95 cents. Mr. Depoe's shortage in pounds is nearly 7,000 at prices between 58 cents and 82 cents.

(b) The Physical Facts, Including the Documentary Evidence, in Support of the Lost Milk Production.

We pointed out in Section III (a) above that in the fiscal year 12/1/48 - 11/30/49 the Rawnsley farm, as shown by the D.H.I.A. record book, produced 430 pounds B.F. on the average. Over six months before that year began, the herd stopped eating anything that could have been contaminated (VI-1167). Not until four months after that test year began did it consume home grown feed again (VI-1169). *Prior* to that year it consumed home grown feed and produced less and *after* that year it steadily declined (Sec. III (a)). The greatest *rate* of decline after the year 12/1/48 - 11/30/49 was in the year 12/1/52 - 11/30/53, (Sec. III (a)) and in that year appellee emitted 80% more fluorides than previously because it had expanded its production (VII-1673). This production performance is based on the physical facts alone, as shown by Mr. Rawnsley's testimony as to where the cattle were and what they ate.

The physical facts as to Whiteaker (Sec. (a) above) are that at Kalama, 10 miles from Reynolds, the herd average gradually increased from 345.2 butterfat for the year 5/1/45 - 4/30/46 to 357 butterfat for the year 5/1/46 - 4/1/47. The *rate* of increase went up at Kalama in the next year ending 4/30/48 *when the Reynolds plant was closed* and was 373.9. Then the herd moved next door to Reynolds *and the plant reopened*. There was an immediate decline of over 15% to 317. Except for the year 5/1/51 - 4/30/52, the herd production has stayed about that level. In the year just mentioned it went up from 307 to 335. It isn't hard to find the reason for that either. Mr. Whiteaker testified that starting in October, 1951, there was a substantial infusion of new blood in the herd (VI-1506, 7). When Reynolds substantially increased its production in the fall of 1952, thereby materially increasing the fluorides on the Whiteaker's grass, there was a decrease of 10% to 303 for the year 5/1/52 - 4/30/53 though only one-half of that year was affected by the increased fluorides (August 1952 - April 1953). 303 was the lowest the herd ever produced.

Concerning the Camas-Washougal area, the Hester production performance also clearly shows the connection between fluoride intake and butterfat production. Mr. Hester testified how many cows he had at Washougal and Aurora and his milk vouchers at both places are in the Record. He was at Washougal from June 1947 to September 1951 (IV-338) and has since lived in Aurora (IV-337). Mr. Hester's winter roughage at Washougal the first two winters he was there was substantially all home grown (IV-380, 407); and it was sub-

stantially all Goldendale hay thereafter. Of course, he was away from fluorides after September, 1951. For the first two years (beginning in each case in December) at Washougal, Mr. Hester's average production was steady and bad; it was about 210 pounds B.F. For the year December 1949 - 1950 it was about 285; and for the next year it was nearly 325 with the last one-third of the year at Aurora. In April 1952 the herd was hit with Bangs disease (IV-340) and the age of the herd at the time of trial was four to five years. At Washougal it had been six to seven years. (Mr. Ross (V-780) and Mr. Rawnsley (VI-1186) defined the term "mature equivalent" to the effect that young cows' production is adjusted to allow for their immaturity.) Despite the change in age, the Hester's production has remained at about 325.

IV PLAINTIFFS' EXPERTS ON THE COW TROUBLES AND THE LOST MILK.

So far we have attempted to show that appellants' cattle were injured substantially (a) because the cows had something wrong with them in fact; and (b) because the cows were producing less than they should have. On these two subjects appellants' experts corroborated appellants. They also did some observing of their own and formed certain opinions. Let us review their testimony.

Dr. Keller was the regular veterinarian for the *Arvidson* appellants from 1945 till he went into the Army in 1952. When he first got into the Camas area where the herds were, here's what he found:

"I moved to Camas-Washougal area as I have stated in the fall of 1945. Shortly after that through my own observations of the animals, through the complaints of the farmers, their troubles and just living with it, in the area, running a general practice, we became aware that there was some problem, acute problem in the area.

Q. What was the nature of the complaints you were told about?

A. The complaints and observations were of such things as the animals for production, the animals not producing as the farmers stated the way they should, and buying better bulls all the time. Buy better cows yet can't produce any milk; their heat cycles, the animal did not come in heat after freshening, therefore they do not, are not able to keep up what they call Grade A basic milking production as they should.

Q. Will you explain that a little?

A. Dairymen in selling milk is not just paid for all his milk at one price. He has what we call a basic. In other words, that is a minimum amount of milk he produces usually ascertained as to the minimum two months of any year. That is his basic and that is the way it is ascertained. In other words, what they are trying to get at is for a dairyman not to produce milk during the lush grass months, but rather keep a constant milking for the year around. Therefore, he gets a much higher price for what we call the basic amount of butterfat that he has and the rest of his milk goes for what we call a surplus or a price much less than his basic. Therefore, it is advantageous for him to have his cattle freshening at regular intervals the year around to keep up a constant and even milk flow. It benefits him very much financially.

Q. Go ahead, what other conditions were reported to you, if any were?

A. Conditions such as the heifers being stunted, not growing as they should even though they were grading them. Such things as that.

Of course by observation I observed teeth lesions, complaints, both from my personal observation and also the farmers' history, diarrhea in the animals. Also hoof complaints and observations of animals walking stiff, of animals' hoofs abnormally growing out and generally unhealthy and unthrifty condition of the dairy herds from men that I knew are good dairymen from being with them and seeing the way they are running their dairy farms." (III-245-247)

Dr. Keller investigated these complaints and soon concluded that the problem was fluorosis which he defined as follows:

"Q. Now Doctor, based on the investigation that you were telling us about and your study of this problem, can you advise the Court as to what the symptoms of fluorosis are in cattle?

A. In my opinion there are two distinct classes of symptoms of fluorine poisoning in cattle. One is the acute symptoms of fluorosis such as diarrhea, lack of appetite. Under acute you can put reduced milk production also. Rough hair coat, lameness, walking with a rather arch in their back. Also we have the symptoms of chronic fluorosis which are evidenced by mottling, staining, abnormal wear of the teeth, exostosis of the bones, elongated feet, and also lamenesses that are caused by permanent bone malformations or exostosis.

THE COURT: Is fluorosis a kind of a general term that refers to all kinds of disabilities that comes from fluorine, or is it limited to a certain kind? What does that word mean?

* * *

A. Fluorosis is in my opinion a term, explanation of the term is the, is syndrom of both chronic and acute symptoms produced in cattle by the ingestion of fluorine compounds." (III-250-251)

He continued to work on the problem. In 1950 he extensively surveyed areas around aluminum plants and away from them with another veterinarian; he found no symptoms in the outside areas. Based on seven years' histories as to the Camas area plus his observations of the teeth and condition of the cattle, Dr. Keller testified that the *Arvidson* herds had fluorosis as of the time he was testifying and earlier. He felt sure that the Hester cattle were in much better shape when he saw them in Aurora, Oregon, than they had been at Washougal (III-271). Fluorosis was present in the *Whiteaker* herds also as of November 1953, said Dr. Keller. These latter herds he had seen but once, but, of course, he had his general background to aid in diagnosis.

Dr. Guard had seen the *Arvidson* herds but once, but he had been the regular veterinarian for the *Whiteaker* plaintiffs since 1946. As to the *Arvidson* herds, Dr. Guard did not see Hester's or Stauffer's and he was unwilling to make a diagnosis of the Norelius, Johnston and Ray Arvidson herds because the tooth picture was inconclusive and he did not have the histories (VII-1780, 1784, 1785).

Dr. Guard had not only been the regular veterinarian for the *Whiteaker* herds; he had examined 100 herds in the Longview area for fluorosis (VII-1747), including some for appellee (VII-1786). On cross-examination, he said he thought all 100 herds were affected by fluorosis except those protected by a hill between them and the Reynolds plant (VII-1805). In the summer of 1953 he saw three herds in the Longview area and located near the Rawnsley, Goldsmith and Josephson places. He

named the owners and at that point in his testimony generalized to say that in his opinion the herds *are worse now (1953) than they were a couple of years ago (VII-1760)*. Dr. Guard was in general agreement with Dr. Keller's definition of fluorosis (VII-1748).

Probably the sharpest area of conflict between Drs. Keller and Guard on the one hand and appellee's veterinarians on the other is that Drs. Keller and Guard believed that cows were necessarily injured systemically (i.e., for example, they were producing less milk than they should) if there were fluorine stains on their teeth. On cross-examination Dr. Keller put it this way:

"Q. Is it conceivable that this condition where teeth are stained can be characterized just as a cosmetic matter, that is, just a matter of appearance and nothing else from the standpoint of the animal's wellbeing?

A. I don't understand your meaning of cosmetic there.

Q. Is it possible to have stained teeth without skeletal or systemic damage to the animal, that is, without these other symptoms that you referred to?

A. In my opinion, no on acute fluorosis.

Q. In other words, you would state that wherever you had stained teeth it would mean that there would be some other damage to the animal?

A. Where you have the chronic symptoms of fluorosis I believe that there is an internal damage also. If the animal is taken out of the area, then the acute symptoms probably and will most of them not be evident.

Q. Is it possible to have damage—is it possible to just have the stained teeth without any other impact upon the animal physically?

A. In my opinion when the animal has ingested enough fluorine to stain the teeth there is very, very great internal and systemic damage." (III-311-312)

On direct examination, particularly with reference to the Goldsmith (VII-1770) and Ford (VII-1779) herds, Dr. Guard corroborated Dr. Keller. Dr. Guard's opinion was that if some animals in a herd showed fluorine stains on the teeth, the milk production of the *herd* was affected. He made this very clear on cross-examination as follows:

"Q. (Continuing) Dr. Guard, I now refer to your statement with reference to the damaging effect of fluorosis on the herd as to its—strike that out. You recall testifying, Dr. Guard, before noon recess that if you find fluorosis in some of the cows of a particular herd you diagnose the entire herd as being damaged by fluorosis, is that correct?

A. I have always made that assumption, yes.

Q. And under those circumstances that herd has no value as a dairy herd in that place; you recall saying that?

A. I will qualify it to say a profitable dairy herd." (VII-1826)

In support of Dr. Keller's and Dr. Guard's opinions, it is worth pointing out that Dr. Guard, upon a routine post mortem examination of a Rawnsley cow, had discovered considerable kidney damage and completely destroyed gland tissue (VII-1839). Dr. Guard also considered, in his testimony, the physical fact that the *Whiteaker* herds had fallen off considerably since the fall of 1952 when Reynolds started putting out 80% more fluorides than formerly (VII-1673). He said:

"Q. Doctor, there is evidence in this lawsuit that those four herds that you have been taking care of in Longview since 1946 have fallen off very considerably in their milk production beginning last fall. Those are the figures I read you this morning. In the light of that fact, which is in evidence here,

what have you to say as to economic damage to those animals?

A. Well, that is why I have drawn my conclusions that when their ingestion of poison which affects metabolism so severely and the first symptoms that a cow shows whether it is fluorine poisoning or too much apples, they drop in the milk production. I mean that is one of the first symptoms that an animal takes in something abnormal to her system before they even have time to bother the teeth, would make her drop in milk production.

Q. *In other words, the first thing that happens when a cow gets sick is that she loses milk?*

A. Right." (VII-1836-37, emphasis supplied)

It was also Dr. Chapman's view (for appellee) that loss of milk production was the first characteristic of a sick cow (VIII-2134-35).

As pointed out in Section V below, defendant's three veterinarians' views to the contrary of the views expressed by Drs. Keller and Guard have considerably less support in the transcript. Other things being equal, they did not see the cows nearly as often, they had no histories to work from, they took no production records into consideration and they conducted no post-mortems.

Rex Ross was appellants' cattle expert. Appellee apparently could find no witness to rebut what he said. Mr. Ross gave his opinion as to what all eight dairy farms (except Mr. Rawnsley's) would produce under normal conditions and he also said what their culling rates would be under normal circumstances.

As to the weight of his testimony, Mr. Ross has imported some 60 Jersey cattle which sold here from \$1800 to \$5000. When he first bought cattle on the Island of

Jersey there wasn't much available in the way of production records, and so he judged production solely on conformation (and, at average prices, he bet \$180,000 on that judgment) (V-771). Testifying in Tacoma, Mr. Ross said on cross-examination that he did not rely on, or even consult, production records even where they were available in buying cows for his own herd (VII-1569-70).

Mr. Ross is frequently a judge at stock shows (V-772); he was president of a milk distributing outfit for 10 years (V-773); and he was President of the Oregon Jersey Cattle Club for two years. He frequently buys cows for commercial operators (V-775).

With this background, particularly with his experience in buying cattle by eye alone, it is not surprising that Mr. Ross was able to state what production would be obtained under normal conditions as to the *Arvidson* herds though he saw them only in 1951 and in 1953 and to state what normal production would be as to the *Whiteaker* herds (except Rawnsley's) though he saw them only in 1953. His normals were based not only on the cattle themselves, but on the manner in which they were cared for, what they were fed, etc. (See, for example, his discussion of the Isbister herd (V-785-790).) The fact that Mr. Ross did not know what the *Arvidson* herds were actually producing before he saw them (V-814) nor before he testified (V-834) is additional evidence of his ability to judge production by eye alone. The approximate result of the difference, in terms of lost butterfat, between Mr. Ross' normal production

and actual production is summarily stated in Section III(a) above.

Further support for Mr. Ross' normals lies in the Whiteaker settlement story. Normal at that farm would be 400 pounds B.F., Mr. Ross said (VII-1550). When Reynolds settled with the Whiteakers up to November 1948, they were allowed 20% in addition to actual production for the three prior fiscal years (VI-1474). Those three years average 358.7 (Section III(a)) and *only one of those years was a non-fluorine year* (Section III(b)). 358.7 plus 20% equals 430.4.

Mr. Ross also testified what normal culling ought to be. Mr. Isbister's should be 10 to 15%; Mr. Stauffer's, 18 to 20%, and Mr. Baker's 15 to 18% (V-819, 821). Mr. Isbister was raising two to three heifers per year (IV-485) for a herd averaging 7.1 cows (IV-473). This is a culling rate of about 35%. Mr. Stauffer has had 27 cows on the average beginning in 1948 (IV-660). He raises seven to 10 heifers per year which are not enough to keep the herd going (IV-627). This is a cull of over 32%. Mr. Baker has averaged 28 cows (IV-671); he raises six to eight heifers per year (IV-675) for a cull of 25%.

Finally with respect to Mr. Ross' testimony, he had occasion to see the Hester cattle several times after they were moved to Aurora. They are in better shape now than when he first saw them in 1951 after the move from Washougal (V-818). In seeing appellants' cattle, Mr. Ross saw quite a lot of scouring and rough hair coats (V-825). He also saw some stiffness in the herds

and he mentioned the Depoe herd in this connection. Mr. Ross corroborated Mr. Rawnsley in general as to the duration of a normal lactation (V-830).

Mr. Coie was the Manager of Evergreen Breeders, an artificial insemination organization. Sires from Evergreen have been used in the Rawnsley herd since 1947. Beginning in 1952, the Evergreen producing daughters constituted the majority of the herd and in 1953 strongly predominated (VI-1279). As of the time he was testifying, Mr. Coie felt normal production of the Rawnsley herd would be 485 B.F. (VI-1279) which is only 55 pounds more than it did do (without Evergreen) in the fiscal year ending in 1949. In that year the herd had been subjected to the least amount of fluorine in any year for which records are available (Sec. III(a)). Exhibit 914 shows the high quality of the Evergreen bulls used at the Rawnsley place. One, for example, used on farms other than Rawnsley's, increased the daughters' production over their dams by 64 pounds B.F. (VI-1266). Clearly this confirms the reasonableness of Mr. Coie's normal.

Mr. Coie was thoroughly familiar with the Rawnsley farm and the Rawnsley cows. He had been on the farm from time to time over the last 10 years (VI-1260). He also was familiar with what fluorosis cows looked like, having seen them when he was County Agent for Clark County in 1942-1946 (VI-1258). In going over the Rawnsley farm he had observed the quality and amount of the roughage grown there and thought the place would carry 50-60 cows and their replacements

(it has averaged about 36 cows for the last six years (Sec. III(a)). He had seen Mr. Rawnsley feed his cows and thought he fed good quality feed liberally (VI-1271). He took these factors into consideration in estimating normal production (VI-1279).

Mr. Coie was on the place in June, 1953. He thought (as did Mr. Rawnsley) that the cattle were 30% under-size; that they were stiff, thin and long haired and that the calves were a disgrace (VI-1283). On cross-examination, Mr. Coie said he knew how the cattle were fed because he had studied the feed records (VI-1293).

Dr. A. O. Shaw, Chairman of the Department of Dairy Science at Washington State, is a specialist in the nutrition of dairy cattle. He had prepared an exhibit (915-332) which showed how much nutrients it took to produce various amounts of milk. This exhibit was received without objection (VIII-2151). Dr. Shaw had visited six of the eight farms discussed in this brief. On the witness stand he was informed what Messrs. Rawnsley, Josephson and Goldsmith fed their cattle and he testified that what they fed was enough to maintain body weight and make the normal production the cattle experts had testified to (VIII-2163-2166). At that point the following stipulation was entered into:

“MR. CRONAN: Your Honor, I believe it may be stipulated between myself and counsel for the defendant that the witness, Dr. Shaw, has familiarized himself with the amounts of feed fed by the farmers in each of the cases now being tried and that his opinion would be if asked, that that level of feed intake is sufficient to support the production on the average per cow in each herd in litigation

under normal circumstances as that production is defined under normal circumstances in this record.

THE COURT: To which the defendant stipulates that the witness would so testify, and you want your reservation of your objection to it on the grounds that you already stated, namely speculative and so forth, is that right?

MR. YERKE: Yes, and also, of course, your Honor, the additional objection that the hypothetical question fails to take into consideration the age and breeds of the animals involved.

THE COURT: As I understand it, the matters that may be assumed by the witness are basically the same matters obtained by Mr. Ross by way of hypothesis when he testified what he considered normal production under normal circumstances.

MR. CRONAN: Yes.

MR. YERKE: All right.

MR. CRONAN: Also the normal levels are those testified to by Mr. Ross.

THE COURT: Very well. The objection will be overruled and the stipulation will be received and I will then understand from this that the witness now on the stand would, if he were taken through each of the several herds, testify that in his opinion the quantity of feed referred to in the testimony of the several claimants for plaintiffs would produce the quantity of butterfat per cow per herd per year that has been put into the record by the witness Ross and witness Coie, correct?

MR. CRONAN: Correct, your Honor." (VIII-2168-2170)

Dr. Cheldelin's testimony concluded the trial. He is an Oregon State College bio-chemist. He has done research work with *organic* and *inorganic* fluorides which involved taking the enzyme systems out of animals and studying their behavior as they oxidize glucose in the presence of both types of fluorides (IX-2516). Although

an aluminum plant discharges inorganic fluorides, his opinion was that the grasses with which they come in contact would convert some of them into organic fluorides (IX-2518), and that the organic fluoride which would be the most likely product is fluoro-acetate (IX-2524). Dr. Cheldelin has personally experimented on animal tissue with fluoro-acetate and sodium fluoride (as indicated in Sec. V below, appellee's experts used the latter exclusively) (IX-2525). Dr. Cheldelin explained that sodium fluoride will block the conversion of starch, but not fat or protein so that it takes a lot more sodium fluoride to have a lethal effect upon an animal (IX-2528). On larger animals, from a visual standpoint, sodium fluoride will cause a discoloration of the teeth, but fluoro-acetate will cause a reduction in the rate of metabolic processes (IX-2531). A cow receiving a sublethal dose of fluoro-acetate would accordingly lose milk production as an *early effect*. 1 ppm in the forage of a 1200-pound cow would be enough to cause severely toxic effects, if not death (IX-2535). Dr. Cheldelin was asked to comment on the relation between feeding sodium fluoride at rates from 7 to 75 ppm (appellee's experts' experiments) and the feeding of forage which had been exposed to hydrofluoric acid and cryolite from an aluminum plant. He saw no connection between the two, although the sodium fluoride feeding would demonstrate the effect of sodium fluoride (IX-2534).

We grant that Dr. Cheldelin had never extracted fluoro-acetate from grass growing around an aluminum plant. He had experimented with fluoro-acetate, though, and knew its effects. In view of the unquestionable fact

that plaintiffs' cattle produced less with Reynolds' fluorine (Section III) than without it, is not Dr. Cheldelin's view that they were eating something having a different effect than sodium fluoride more reasonable than the opinion for appellee that they were eating the equivalent of sodium fluoride?

V COMMENTS ON THE DEFENSE AT THE TRIAL.

Appellee took the unqualified position that no farmer had suffered any loss in his operation that was connected with or attributable to Reynolds' operations. Speaking generally, appellee produced, in support of this proposition, Drs. Phillips and Schmidt who never saw any of the cattle, but who were conducting admittedly uncompleted experiments, respectively in Wisconsin and California. These experiments were being carried on for the purpose of showing that milk cows fed *sodium fluoride* for the first time *after* they reached maturity at levels in excess of the fluoride levels to which appellants' cows were subjected, suffered no damage. This, of course, assumes that sodium fluoride has the same effect as fluorides from an aluminum plant. Whatever the effect of sodium fluoride upon milk cows may be, Section III(b) of this brief indicates from the physical facts in evidence alone that fluorides from an aluminum plant do cause a loss in milk production. Moreover, Dr. Cheldelin's testimony reviewed just above in Section IV raises at least a very considerable doubt that the cattle were consuming the equivalent of sodium fluoride.

Appellee also produced three veterinarians, Drs. Garlick, Phelps and Chapman. Dr. Garlick saw the *Arvidson*

herds once in 1951 and the *Whiteaker* herds once in 1952. Dr. Phelps saw the *Arvidson* herds in 1951 with Dr. Garlick; and he saw them again late in the summer and fall of 1953. Dr. Phelps saw the *Whiteaker* herds in the summer and fall of 1953 as did Dr. Chapman. Dr. Chapman also saw the *Arvidson* herds in the summer and fall of 1953 with Dr. Phelps. Some of these herds were seen several times by one or more of the veterinarians. Substantially, though, Drs. Phelps and Chapman saw the *Arvidson* and *Whiteaker* herds just before trial; Drs. Garlick and Phelps saw the *Arvidson* herds two years earlier in 1951; and Dr. Garlick saw the *Whiteaker* herds late in 1952.

With one or two exceptions not worth mentioning, the veterinarians who saw the cattle for appellee saw nothing wrong with them when they were there and inferred there had been no economic damage. With the exception of Dr. Garlick, who looked into the *Whiteakers'* milk production once early in 1951, nobody testified for appellee as to whether the actual milk production was more, less or about the same as it should have been. All of appellants' production records in both cases were available to appellee before trial; in fact, the *Whiteaker* plaintiffs' herd books are still marked as deposition exhibits.

We think the reason nobody testified for appellee as to how close the actual production was to what it should have been is because the production records would not stand analysis and appellee knew it. Instead of producing cattle experts, appellee relied on the admittedly incomplete experimental work of Drs. Phillips and Schmidt

and the three veterinarians. The three veterinarians had done no experimental work of their own relating fluorine intake to butterfat loss. They nevertheless took the position that there couldn't have been any butterfat loss because the degree of tooth damage was too slight to warrant it. In so concluding, they were obviously relying on the incomplete experimental work of Drs. Phillips and Schmidt.

This incomplete experimental-seldom seen cattle defense prevailed in the trial Court. Obviously the trial Court gave more weight to it than to (a) observations of dairymen who had operated in and out of fluorine conditions for as long as 40 years, (b) the physical facts clearly showing that there was a butterfat loss, and (c) plaintiff's experts. The trial Court particularly relied on Drs. Phillips and Schmidt (I-93-4).

No invidious comparison is here intended between the experts on the two sides. Other things being equal, however, it is pretty clear that Drs. Keller and Guard were in a better position to diagnose the presence or absence of fluorosis in appellants' cattle than were Drs. Garlick, Phelps and Chapman. Starting about eight years before the trial, Drs. Keller and Guard were the regular veterinarians for appellants' herds. Accordingly, they were in a much better position than appellee's veterinarians to observe and they did observe the abnormalities of which the farmers complained.

Appellants' cattle expert, Mr. Ross, was qualified to judge production based solely on observation. As we have seen, he bought cattle without considering produc-

tion records either because there weren't any or, if there were, because he didn't think it was necessary. He testified what appellants' cows (except the Rawnsley cows) would produce under normal conditions. Mr. Coie, speaking from his personal knowledge of the sires used in the Rawnsley herd and his personal knowledge of the farm, testified as to those cows' normal production. Dr. Shaw, a clearly qualified nutrition expert, testified that what the farmers said they fed was enough to maintain body weight and the normal production testified to by Messrs. Ross and Coie. Appellant *made no effort whatever to rebut any of the testimony referred to in this paragraph.*

Dr. Cheldelin did not disagree with the sodium fluoride work of Drs. Phillips and Schmidt. He did, however, testify that what the cattle were eating was not the equivalent of sodium fluoride.

We shall close our remarks on the trial defense by commenting briefly on the testimony of Drs. Garlick, Phelps and Chapman.

Dr. Garlick was not unfamiliar with the complaints voiced by the farmers in the present cases. When he was in private practice in Tacoma, Washington, he was the regular veterinarian for the Eschbach herd which is near the Tacoma aluminum plant. In 1942 here's what he observed wrong with the Eschbach herd:

"A. Well, when the animals become ill the first thing I noticed was, in the Eschbach herd of course, and that was a lameness, very acute lameness in the front feet particularly inside claws of the front feet, and that lameness interfered with the ability of the

animals to forage. There was a concurrent loss in the body weight. There was a deterioration of the animal as far as general health was concerned.

It showed such known specific symptoms as rough hair coat. Those animals that were down and could not walk around did not wear back their feet properly and so the—the toes had a tendency to grow out. There was a drop in milk production in that herd.” (VII-1859-60)

Dr. Garlick later testified that slight mottling of teeth could occur without the occurrence of any of the Eschbach symptoms, which symptoms he described as “systemic”. However, what level of fluorides the Eschbach herd encountered and what the condition of their teeth was, Dr. Garlick did not say.

When Dr. Garlick saw the Depoe (one of appellants) herd he took some pictures of some animals with an odd stance. He commented on the pictures at the trial and said the trouble was osteomalacia, not fluorosis. He distinguished between the two on cross-examination as follows:

“Q. You have seen many cows that had fluorosis that had exactly that same gait and same stance, haven’t you?

A. No, I have not. There is a difference because *in fluorosis animals the tenderness is very acute in the front feet* and an animal that has fluorosis will generally go down on her knees or stand with her legs doubled forward, her front legs doubled forward and trying to take as much weight off as possible over those front legs rather than trying to evenly distribute it over the four.” (VII-1873, emphasis supplied.)

Mr. Isbister encountered precisely this difficulty with the front feet of his animals (IV-479).

Dr. Garlick saw the production results in the Whiteaker herd book in May, 1951 (VIII-1919). At that time he also saw the animals in the field but he did not look at any teeth although he knew flourine might have been a problem in May, 1951, because the herd was in a fluorine area (VIII-1956). Based upon Dr. Garlick's field observation in May, 1951 and his study of the herd book at that time, he concluded that an adequate production level would be 365 B.F. on the average ("approximately a pound of butterfat per day" (VIII-1958)). When Dr. Garlick saw the herd book, the herd had just completed the year 5/1/50 - 4/30/51 and was doing 307 (Sec. III (a)). Sterility accounted for its failure to do 365, according to Dr. Garlick. He didn't know the reason for the sterility (VIII-1921).

The diagnosis of sterility begs the question, we think. Among other difficulties reported by the farmers to Dr. Keller when he first got to the Camas-Washougal area in 1945 were disturbed heat (oestrus) cycles in the cows (III-245-6). On cross-examination of Dr. Garlick the following occurred:

"Q. Dr. Garlick, are you familiar with this Bulletin 123, Research Bulletin 123, October 1934, Agricultural Experiment Station of the University of Wisconsin, "Chronic Toxicosis in Dairy Cows Due to the Ingestion of Fluorine" by Paul H. Phillips, E. B. Hart and G. Bohstedt?

A. I am.

Q. Would you agree or disagree with this statement under the summary and conclusions on page 28, conclusion three:

'Fluorine in the ration of dairy cows does not cause a functional failure of the reproductive

processes, but it does delay oestrus following parturition and lowers the birth rate of newborn calves. The nutritional state of the animals suffering from chronic fluorosis is thought to be responsible for these results.'

Do you agree?

A. I agree that Dr. Phillips is recording his observation. However, I have not observed it in my observations and the other workers who have observed it in regions of the aluminum plants have not observed the condition." (VIII-1959-60)

While Dr. Garlick does not agree with the above quotation from Dr. Phillips, and Dr. Phillips himself has now considerably limited it, Dr. Garlick is still confronted with the other Whiteaker D.H.I.A. results. Since there is a variation of 303 to 373.9 in the Whiteaker annual results and since Dr. Garlick thought 365 would be normal, it is evident, if the 365 is correct, that sterility has not always been a problem. If the herd had a sterility problem at 307 average production in May 1951, why was it at 303 in May 1953? Was there still a sterility problem? And if there was, why is it that the herd went up from 307 to 335 in the year after Dr. Garlick looked at the herd book? When Dr. Garlick saw the herd in December, 1952, the herd book, which he did not then look at (VIII-1976), showed 335 as of 4/30/52. At that stage Dr. Garlick, had he looked at the book, might have thought he had been right about sterility in 1951 since the herd production was up 10% and since there had been a considerable infusion of new blood in the herd beginning October 1951. How would he feel about this though, in view of the fact that the herd again plunged to 303 in the year ending 4/30/53? If Dr. Gar-

lick had really been trying to diagnose the herd, would he not have informed himself a little better? Had he done so, we think he would have discovered that the only real variable in the Whiteaker situation (Sec. III(b)) is the amount of fluorides consumed by the herd.

It will also be recalled that Dr. Garlick did not see the *Arvidson* herds after the summer of 1951 nor the *Whiteaker* herds after December 1952. No fluorine changes take place in the teeth after the bud stage (when the tooth can't be seen), Dr. Garlick informed the Court (VIII-1948). Dr. Garlick did not say how long the bud stage was, but Dr. Phelps said it was six months (VIII-1947). Even after the tooth emerges from the gum, Dr. Garlick can't tell about exposure to fluorine till the cuticle wears off (VII-1861). Dr. Garlick's knowledge of fluorosis in *Arvidson*, when he testified, therefore, was not more up to date than three years earlier. Since he saw the *Whiteaker* herds only in December 1952, he could have seen nothing on the teeth with respect to Reynolds' 80% increase in fluoride discharge which took place in August 1952.

On cross-examination Dr. Phelps made it very clear that when he was talking about "fluorosis" he was describing the point where there is "systemic damage" to the animal (IX-2325). On direct, he had said that cows could have mottled teeth without fluorosis. On cross he went on to say that until the "systemic" stage was reached, there was no loss in milk production (IX-2347). Dr. Phelps had found no "systemic" damage on such visits as he made for this litigation. Nor had he when testifying on at least two, and possibly three, previous occa-

sions (IX-2361-3). However, when participating in settling claims for Reynolds, Dr. Phelps' attitude was somewhat different. He admitted on cross-examination that when he made a report for Reynolds in connection with the Whiteaker release, the animals had not been systemically injured (IX-2336). In connection with the Rawnsley release, five cows were systemically injured (IX-2341). Others had mottled teeth and were not systemically injured (IX-2343). No animals were systemically injured when Goldsmith's claim was settled (IX-2346). Dr. Phelps finally admitted that in connection with these releases he had determined the difference between normal and salvage values in all cases where there was *any* mottling (IX-2343) and that the reason this was done was because we (meaning Reynolds and himself (IX-2344)) " . . . were probably going overboard a little bit . . . " (IX-2343). Dr. Phelps does not go overboard in litigation.

Dr. Chapman has changed his opinion somewhat too. At the trial he made it clear that when he was talking about "fluorosis" he meant damage (VIII-2115). He said on cross-examination that the first symptom of fluorosis was mottling of the teeth (VIII-2123). In connection with that statement, there was read to Dr. Chapman an extract from an article written by him when he was employed by Oregon State College to make a survey of fluorosis. The extract and the surrounding colloquy was:

"Q. What do you consider the first symptoms of fluorosis in dairy cattle?

A. I think the *first thing I notice will be mottling of the teeth.*

Q. Would you agree with this statement [from the Chapman article]:

‘Symptoms develop slowly and are *most noticeable in lactating cows*. *Early symptoms* are decreased food consumption, *decreased lactation*, intermittent diarrhea and general loss of condition and appetite. *As the diet progresses there may be changes in bones and teeth.*’

Would you agree with that?

A. No.

Q. Would you agree with this statement:-

A. I got my sequence mixed up.

‘Young animals make a poor growth and often appear to be suffering—’

THE COURT: Excuse me, just a minute. What did you say there?

THE WITNESS: The sequence.

THE COURT: Oh, the sequence of the symptoms?

THE WITNESS: Of the symptoms.

THE COURT: I see.

Q. (Continuing) You changed your mind as to that?

A. That is right.” (VIII-2123-24, emphasis supplied.)

Later, on recross-examination, Dr. Chapman made it pretty clear that his sequence was right when he wrote the article. He said:

“Q. Any little thing upsets their milk production, don’t it?

A. Yes, practically anything that would upset it, upset her normal eating or even disturbance, *just examining the cattle will upset the milk production slightly.*

Q. Sure, depending on the degree? On the other hand, if some farmer called you some night and tells you he has got a sick cow, it is quite the common practice among veterinarians to ask, ‘Well,

how much is she off on her milk production?’

A. One of the first things you ask.

Q. One of the first things you ask?

A. That is right.

Q. And if she isn’t off on her production very much you don’t consider it too terribly serious?

A. I will think she will wait until morning, and if they don’t get any, I say, ‘Well, it is too late to autopsy.’ (Laughter)

Q. It doesn’t take very much to throw her off milk production, does it?

A. Well, *it doesn’t take any marked change to alter the milk production of a cow.*” (VIII-2134-35, emphasis supplied.)

Earlier in this portion of our brief (p. 77) we noted that appellee’s defense at the trial was an incomplete experimental-seldom seen cattle defense. We also pointed out that appellee’s veterinarians, who saw the cattle but little, were basing their conclusions that the cattle couldn’t have been injured on the incomplete experiments of Drs. Phillips and Schmidt who had not seen the cattle at all. While appellants produced some experts also, the trial presented no mere battle of experts. Supporting appellants’ experts were the personal day by day observations of appellants themselves whose testimony showed a remarkable consistency as to the type of injuries suffered by their cattle (Point II, Sec. I) and the physical facts including the documentary evidence (Point II, Sec. III (b)) showing that there really was a milk loss.

The defense was solely and completely an expert defense. In 32 C.J.S., Evidence at p. 393, §569 appears this statement: “. . . courts of the highest eminence . . . feel that experts are frequently rather the hired advo-

cates of the parties than men of science placing their special experience at the service of the cause of justice . . . ” A recent opinion of the Oregon Supreme Court is to the same effect. In *Oxley v. Linnton Plywood Ass'n*, 60 Ore. Adv. Sh. 1027 at p. 1049 (May 25, 1955), the Court observed: “ . . . The cruiser testifies as an expert witness, and his testimony, like that of all expert witnesses, is viewed with some suspicion . . . ”

POINT III

The Washington Law of Limitations as to Real and Personal Properties and the Washington Substantive Law of Trespass.

A. Rulings of the Trial Court.

B. The Washington Law of Limitations and of Substantive Law concerning Trespass to Real Property.

Revised Code of Washington (R.C.W.) 4.16.080 (1);

Suter v. Wenatchee Water Power Co., 35 Wash. 1, 76 Pac. 298;

Weller v. Snoqualmie Falls Lbr. Co., 155 Wash. 526, 285 Pac. 446;

Riblet v. Spokane-Portland Cement Co., 41 Wn. (2d) 249, 248 P. (2d) 380;

Welch v. Seattle & Montana R. Co., 56 Wash., 97, Pac. ;

Gray v. Harris & Son, 200 Wash. 181, 93 P. (2d) 385;

Clark Lloyd Lum. Co. v. Puget Sound & C.R. Co., 92 Wash. 601, Pac. ;

I Restatement of the Law of Torts, Sec. 158;

Ure v. United States, 93 F. Supp. 779, aff'd sub nom *White v. U. S.* (CA9) 193 F. (2d) 505;
Kerr, et al., and McCallister, et al. v. Reynolds Metals Company;
 87 C.J.S., Trespass, Sec. 13;
 52 Am. Jur., Trespass, Sec. 12, p. 844.

C. The Washington Limitations Law as to Personalty.

Revised Code of Washington (R.C.W.) 4.16.080;
 Revised Code of Washington (R.C.W.) 4.16.130;
Northern Grain & Warehouse Co. v. Holst, 95 Wash., 312, 163 Pac. 775;
Clark Lloyd Lbr. Co. v. Puget Sound & Cascade Ry. Co., 92 Wash. 601, 159 Pac. 774;
Irwin v. J. K. Lumber Co., 119 Wash. 158, 205 Pac. 424;
Constable v. John P. Duke, 144 Wash. 263; 257 Pac. 637;
Noble v. Martin, 191 Wash. 38, 70 P. (2d) 1064;
Luellen v. Aberdeen, 20 Wn. (2d) 594, 148 P. (2d) 849;
 Revised Code of Washington (R.C.W. 4.16.080 (2).

A. Rulings of the Trial Court

Before citing and discussing the authorities, including the Washington authorities, on the substantive law of trespass, and on the Washington law of limitations as to realty and personalty, we want to point out to the Court that these questions were before the trial Court several times. The trespass point first was presented to Judge James Alger Fee, sitting in Tacoma, Washington, upon appellee's motion to transfer the *Arvidson* case from the Western District of Washington, Southern Division, where it was filed, to the District of Oregon. In

an opinion reported in 107 F. Supp. 51, Judge Fee, after analyzing the complaint, denied transfer principally on the ground, as noted in the trial Court's decision (I-96), that an Oregon court would lack jurisdiction over a foreign trespass upon real property because the Oregon Supreme Court had so held.

What Washington period of limitations applied as to both realty and personalty came before the trial Court upon appellee's motion before trial. The trial Court by the trial Judge handed down an informal memorandum and entered orders (I-12, 138) before trial providing that the real and personal properties claims set forth in both complaints were limited by the Washington two-year statute of limitations.

Finally, both trespass and Washington limitations as to realty and personalty in both actions came up on the evidence after trial and was dealt with extensively in the trial Court's decision. The Court quoted from its informal memorandum on the limitations point in again ruling that the two-year statute applied to the claims for damages both to real and personal properties. As to realty, the Court first held that Judge Fee's ruling denying removal was not a ruling on the Washington law (I-96). The Court then applied its own view of the Washington law both as to limitations (I-97) and as to the substantive law (I-99) concluding for both purposes that the actions were trespass on the case actions and not actions in trespass. In so ruling the Court relied principally upon *Suter v. Wenatchee Water Power Co.*, 35 Wash. 1, 76 Pac. 298. The Court recognized that " . . . In all probability some areas in the near vicinity

of the plants receive deposits of particulates or solids in a minute and powdery form . . . ” (I-92). Nevertheless, the Court held that where the claimed injury is direct, trespass lies; but in the cases at bar, the injury, if any, was indirect and the actions were therefore trespass on the case actions (I-99-100). After explaining that the Washington cases, especially the *Suter* case required this distinction, the Court concluded:

“ . . . Even though it were assumed that solids in the form of minute particulates from defendant’s plants have been deposited on plaintiffs’ lands, the injury, if any, resulting therefrom was consequential, the action is on the case, and awards of nominal damages would not be justified by the facts or required by the law.” (I-100)

This quotation plus the Court’s reliance on the *Suter* opinion (which involved a negligence case) is fundamental to the Court’s conclusion that a trespass was not made out as a matter of law. The Court’s view was that the deposits of solids is not enough. There must not only be injury, but direct injury. Our view, on the contrary, is that in a trespass case damages are *presumed* from the breaking (the deposit of solids) of the close: actual damages which are the damages the Court appears to have been discussing, have nothing to do with a trespass case. As we shall see, courts generally, including the Washington Supreme Court, have regularly so held.

In its decision the trial Court again dealt with the limitations point as to personalty. The Court quoted the three year Washington statute expressly dealing with personal property (I-97) but held that it did not apply. It held instead that the two year statute applied and

said this result was "inescapable" (I-97) under six Washington Supreme Court cases which it cited (I-98) but did not analyze at all.

B. The Washington Law of Limitations and of Substantive Law concerning Trespass to Real Property

In taking up the law of limitations and the substantive law of trespass upon real property together, we recognize, as did the trial Court, that the two questions are connected. They are connected because the three year Washington limitations statute (R.C.W. 4.16.080 (1)) specifically covers such actions. It reads so far as presently applicable:

"Within three years:

"1. An action for waste or trespass upon real property; * * * ."

In holding that this three year statute did not apply, the trial Court cited only *Suter v. Wenatchee Water Power Co.*, 35 Wash. 1, 76 Pac. 298; *Weller v. Snoqualmie Falls Lbr. Co.*, 155 Wash. 526, 285 Pac. 446, and *Riblet v. Spokane-Portland Cement Co.*, 41 Wn. (2d) 249, 248 P. (2d) 380 (I-97-98). None of these three cases was pleaded in trespass. The *Suter* case was pleaded in negligence and the *Weller* and *Riblet* cases were pleaded in nuisance. Because of these pleadings, it is difficult to see how the trespass statute could have been held applicable.

The facts in the *Suter* case were that defendant had constructed an irrigation canal. The complaint alleged that the canal had been negligently constructed so that surplus water escaped and flowed over plaintiffs' lands.

A demurrer to this complaint on the ground that the acts complained of occurred more than two years prior to filing was overruled in the trial court. The Supreme Court of Washington reversed. It held that the three year trespass statute did not apply and that the two year statute did. It said the acts complained of did not constitute a trespass. It noted that the theory of the complaint was negligence. In so doing it noted that the original construction of the canal was lawful, if negligent. Therefore any damage to plaintiffs was an indirect consequence of a lawful act. The Court recognized that the distinction between direct and indirect injury was *not* the only test of trespass in these words:

“ . . . One of the [not the only] best test by which to distinguish trespass is found in the answer to the question, when was the damage done? . . . ” (35 Wash., p. 6) (quotation from the *Hicks* case)

Later in the opinion the Court made it very clear that it was holding that the three year trespass statute did not apply because (1) plaintiffs' own theory was negligence and (2) because the original construction of the canal by defendant was lawful. The Court said on these points:

“Respondents argue in their brief that appellant's act was a forcible one, in that they assert it let the waters into the canal through the headgate, and that the injury to their lands was the immediate result of such forcible act. *It is asserted that the water was under appellant's absolute control from the time it entered into its canal from the Wenatchee river until it was let out at the end of the lateral. Such is, however, not the case alleged in the complaint. The complaint is based upon negligence in the construction of the canal, and upon its insuf-*

ficiency to carry the surplus water which accumulated, at the time mentioned, by drainage from above. If such were true, it is manifest that the water was not under the immediate and absolute control of appellant, as respondents now argue. The theory of the complaint is that the injury resulted from *negligent construction*, which occurred long before, and whereby appellant failed to properly handle the waste and surplus water. The act was remote from the injury. The latter was purely consequential, and not the direct or immediate result of the former. Moreover, if respondents' present argument were supported by the allegations and theory of the complaint, then, even though appellant had full control of the water, it still follows, from the reasoning in the cases cited above, that it was *not doing a thing unlawful in itself* when it permitted the water to run through its canal; and if, after running through the canal, it was *negligently* permitted to escape, the appellant was liable for consequential damages recoverable at common law in an action on the case only, and not in an action of trespass. We therefore think that, under the *cause of action stated in the complaint*, our statute of limitations barred the action after two years. It follows that the court erred in overruling the demurrer to the complaint." (35 Wash. pp. 8-9, emphasis supplied.)

As noted above, the trial Court, in refusing to apply the three year trespass statute to the cases at bar, relied on the *Weller* and *Riblet* cases in addition to the *Suter* case. Not only was the *Weller* case pleaded in nuisance; there was no discussion in the Court's opinion of either the substantive law of trespass or of the limitations point as to trespass. In the *Riblet* opinion there was clear recognition that appellant's theory below was nuisance. Appellant nevertheless, in a nuisance case, tried to convince the Court that the three year trespass limita-

tion was properly applicable. This the Court quite correctly rejected (at p. 258 of 41 Wn. (2d)).

As we have seen, the *Suter* opinion refused to apply the three year trespass statute because the theory of the complaint was negligence *and* because the original building of the canal was not unlawful in itself. We submit that the theory of the present complaints is trespass and that it is not lawful in Washington or anywhere else to deposit solids on another's real property.

As to the theory of the complaints, Judge Fee ruled in *Arvidson* in 1952, a year and one-half before trial, that the complaint stated a cause of action in trespass. The opinion is reported at 107 F. Supp. 51 and the holding to that effect is in the first paragraph of the opinion. Because the complaint stated a cause of action in trespass, Judge Fee held that the action could not be removed to Oregon. It could not be removed to Oregon because the Oregon Supreme Court had held Oregon Courts had no jurisdiction over foreign trespasses upon real properties. 107 F. Supp. 51, 52.

The trial Judge was of opinion that this ruling was not a ruling on Washington law (I-96). On the contrary, it seems clear to us that it was a ruling on Washington law. The complaint alleged that the Arvidson farms were in Washington and that appellee had deposited solids on them. If that had not been a Washington trespass, Judge Fee would have been free to order the action to Oregon or at least the Oregon cases dealing with foreign trespass would have been inapplicable, and the whole basis of Judge Fee's opinion summarized in the

preceding paragraph rather pointless. Though Judge Fee's opinion probably became the law of the case, all we find it necessary to point out in what follows is that he was right.

The *Suter* case was decided in 1904. In 1909 the Washington Supreme Court not only held that the Washington law of trespass accords with the common law, but defined what it was at common law. In *Welch v. Seattle & Montana R. Co.*, 56 Wash. 97, 105 Pac. 166 at pp. 99-100 of 56 Wash., the following appears:

"It is the established rule of this court that the question of whether an action is an action for trespass upon real property depends upon what was deemed trespass at the common law, and in order to determine that question it is necessary to examine the common law authorities. In 2 Cooley's Blackstone (4th ed.), page 208, the author says that, 'Trespass in its largest and most extensive sense, signifies any transgression or offence against the law of nature, or society, or of the country in which we live; whether it relates to a man's person, or his property.' But that 'in the limited and confined sense in which we are at present to consider it, it signifies no more than an entry on another man's ground without a lawful authority, and doing some damage, however inconsiderable, to his real property.' The essential idea seems to have been the breaking of a close by force, the words of a writ of trespass commanding the defendants to show cause *quare clausum querentis fregit*; and it was frequently called trespass *vi et armis*. So great a regard did the law have for a man's close or premises that it presumed damages would accrue from the breaking into or penetrating such close, even if it was no more than the trampling of the herbage therein. An action setting forth such facts as these was an action in trespass, as distinguished from what was designated

an action on the case, where the injury resulting from the action was not caused by direct force, but was consequential or an injury resulting indirectly from the act complained of. Mr. Blackstone, on page 123 of Book 3 (Lewis' ed.), makes a distinction as follows:

“ ‘ And it is a settled distinction, that where an act is done which is in itself an *immediate* injury to another's person or property, there the remedy is usually by an action of trespass *vi et armis*; but where there is no act done, but only a culpable omission, or where the act is not immediately injurious, but only by *consequence* and collaterally, there no action of trespass *vi et armis* will lie, but an action on the special case, as the damages consequent on such omission or act.’ ”

The important principle involved in the foregoing extract is that damages are presumed from the breaking of the close. In other words, if defendant breaks the close, liability is absolute, damage or no damage.

This principle was dicta in the *Welch* case because the Court held there was no physical invasion. 56 Wash. 97, 101, 2. The dicta was applied later, however, in *Gray v. Harris & Son*, 200 Wash. 181, 93 P. (2d) 385. There, on one cause of action, plaintiff had been awarded \$100 because defendant had hauled some timber over an old road on plaintiff's real property. The Washington Supreme Court's views were these:

“(4) Appellant contends that the trial court should in no event have allowed more than nominal damages to respondents on their second cause of action.

“There is no question but that appellant was a trespasser upon respondents' land, after redemption. The testimony shows that it hauled over this land

at least 600,000 board feet of timber, after respondents had redeemed, and before this action was begun, with out respondents' permission, and without any right so to do. However, the testimony also shows that the hauling was upon an old road that had been there for some ten years, and that the only damage was such as might result from the use of this private road. The only testimony bearing upon the damage to the land from such hauling seems to be based upon the claimed resonable value per thousand feet for hauling timber over this road. We are of the opinion that there is no testimony herein which would justify a judgment against appellant on the second cause of action in the sum of one hundred dollars, but a technical trespass having been proven, we think respondents are entitled to nominal damages in the sum of one dollar, on their second cause of action." (200 Wash. 181, 188-9.)

Obviously this extract is susceptible only of the meaning that upon proof that the close was broken the liability is absolute without any proof of actual damages.

Clark Lloyd Lum. Co. v. Puget Sound & C.R. Co., 92 Wash. 601, 159 Pac. 774 also dealt with trespass. There the railroad wanted to lay some track along the lumber company's property and the parties entered into an agreement to that effect. In disregard of the rights conferred, the railroad blasted some stumps and threw some debris into a cove where the lumber company maintained some booms. The question presented was whether those acts constituted a trespass for the purpose of the statute of limitations. The Court held that they did. It said:

" . . . The blasting of the stumps and the waste of the debris over the bank and into the cove was an immediate injury. *The damages which may result*

do not have to be immediate to sustain an action under Sec. 159. The statute does not concern itself with the moment of time when the damage actually accrues, or the amount of the damage. They may continue and grow in volume. It concerns itself only with the character of the trespass. If a thing lawful to be done results in damage, the case falls under the two-year statute. If the thing done is wrongful in its inception to the extent that it presently invades a property right, the three year statute applies . . ." (92 Wash. at p. 605)

This extract clearly supports our view that the deposit of solids presently invades a property right whenever the damage was done, and irrespective of the amount of damage.

The common law of trespass has been defined elsewhere exactly the same as it has been defined in Washington. I Restatement of the Law of Torts, Sec. 158 at p. 359 defines trespass at common law as follows:

"One who intentionally and without a consensual or other privilege

(a) Enters land in possession of another or any part thereof or *causes a thing* or third person so to do * * * is liable as a trespasser to the other irrespective of whether harm is thereby caused.
* * * "

Under the comment on clause (a) at page 362 appears the following:

"*n. Causing Entry of a Thing.* The actor without himself entering the land may invade another's interest in its exclusive possession by throwing, propelling or placing a thing either on or beneath the surface of the land or through the air space above it. Thus, in the absence of the possessor's consent or other privilege so to do, it is an actionable trespass to throw rubbish on another's land, even though he

himself uses it as a dump heap, or to fire projectiles or to fly an advertising kite or balloon through the air above it, even though no harm is done to the land or to the possessor's enjoyment of it. *In order that there may be a trespass under the rule stated in this Section, it is not necessary that the foreign matter should be thrown directly and immediately upon the other's land. It is enough that an act is done which will to a substantial certainty result in the entry of the foreign matter.* Thus, one who close to another's boundary so piles sand that by force of gravity alone it slides down onto his neighbor's land or who so builds an embankment that during ordinary rainfalls the dirt from it is washed upon adjacent lands becomes thereby a trespasser on the other's land." (Emphasis supplied.)

The Oregon Federal Court through Judge Fee has had occasion recently to consider the application of the common law of trespass to a particular fact situation. *Ure v. United States*, 93 F. Supp. 779, aff'd sub nom *White v. U.S.*, (CA9) 193 F. (2d) 505. That case involved one group of plaintiffs who sought to prove liability on the theory of negligence for failure of defendant to deliver irrigation water to their crops and another group which sought to prove strict liability on the theory of trespass when their lands were flooded by the breaking of an irrigation canal. Concerning the failure to deliver water, the Court held that no negligence had been proved. Concerning the flooding cases, the Court held that trespass involving strict liability was involved. The Court did so in the following language:

" . . . When one voluntarily and deliberately does an act upon his own land which results in a physical trespass upon lands in other ownership, the liability is absolute . . . " (p. 787 of 93 F. Supp.)

On May 4, 1950, plaintiffs closed their cases before Judge Fee, sitting in Oregon, in *Kerr, et al.*, and *McCallister, et al.*, v. *Reynolds Metals Company*. These were damage actions against the Troutdale plant. Defendant in that case was represented by the same firm as represents appellee here. Some plaintiffs were residents of *Washington* and some of *Oregon*. Defendant moved for and argued a motion for an involuntary nonsuit (Tr. in *Kerr* and *McCallister*, 838) under R. 41-B, F.R.C.P. The Court denied the motion and said:

"Then I think that there is some evidence in this case from which the Court could deduce or infer very properly that there were particles developed in the pots at Reynolds Metals Company that were transferred physically onto the properties of the plaintiffs. As to whether they caused damage or not would then not be a question, because by mere physical invasion plaintiffs have established their case.

* * * *

" * * * The Court is of the necessity of giving at least nominal damages for the trespass which I think up to this point has probably been established, and from there on determine how many of these claims are valid." (Tr. in *Kerr* and *McCallister*, 846.)

87 C.J.S., Trespass, Sec. 13, is in accord with the Restatement trespass rule. It reads:

"Every unauthorized entry is a trespass, regardless of the degree of force used, even if no damage is done or the injury is slight and gives rise to a cause of action for nominal damages at least . . . " (Sec. 13(b) pp. 965-6, citing *Welch v. Seattle & Montana R. Co.*, 56 Wash. 97, 105 P. 166, discussed *supra*.)

"Entry by Thing Controlled by Defendant. The entry need not be in person but may be by the projection of force beyond the boundary of the land where the projecting instrument is employed. Thus, the trespass may be committed by casting earth, or other substances, upon another's land . . . " (Sec. 13(c), pp. 966-7, citing *Ure v. United States*, 93 F. Supp. 779, discussed supra).

To the same effect is 52 Am. Jur, Trespass, Sec. 12, page 844:

"At common law every man's land was deemed to be inclosed, so that every unwarrantable entry on such land necessarily carried with it some damage for which the trespasser was liable. Any entry on land in the peaceable possession of another is deemed a trespass, without regard to the amount of force used, and neither the form of the instrumentality by which the close is broken nor the extent of the damages is material. . . ."

The three text writers and Judge Fee are thus in agreement with the Washington cases as to what constitutes trespass at common law. Accordingly, if the evidence showed (Point I above) that appellee deposited solids, there is no question but that trespasses were made out under the law.

C. The Washington Limitations Law as to Personality.

Under Point III(A) above, we pointed out that the trial Court before (I-12, 138) and after (I-97) trial held that the Washington two year statute applied to the personality claims and not the three year statute. The three year statute reads:

"Within three years:

* * *

"2. An action for taking, detaining or injuring personal property, including an action for the specific recovery thereof, or for any other injury to the person or rights of another not hereinafter enumerated; * * *" (R.C.W. 4.16.080(2))

The two year statute (R.C.W. 4.16.130) reads:

"An action for relief not hereinbefore provided for shall be commenced within two years after the cause of action shall have accrued."

In its written decision the trial Court said it was "fully satisfied" (I-97) the latter of these statutes applied. That conclusion was "inescapable" to the trial Court (I-97), under six cases which it cited, but did not in any way analyze. The six cases are: *Northern Grain & Warehouse Co. v. Holst*, 95 Wash. 312, 163 Pac. 775; *Clark Lloyd Lbr. Co. v. Puget Sound & Cascade Ry. Co.*, 92 Wash. 601, 159 Pac. 774; *Irwin v. J. K. Lumber Co.*, 119 Wash. 158, 205 Pac. 424; *Constable v. John P. Duke*, 144 Wash. 263, 257 Pac. 637; *Noble v. Martin*, 191 Wash. 38, 70 P. (2d) 1064 and *Luellen v. Aberdeen*, 20 Wn. (2d) 594, 148 P. (2d) 849.

We shall analyze the cases cited by the Court. However, it is probably worth pointing out first that the Washington limitations statutes are unique at least in one respect. Most codes have a residuary or "catch-all" statute providing a period of limitations for actions not otherwise dealt with. The Washington two year statute above quoted is such a statute. However, the last clause of the section of the Washington three year statute dealing with personalty above quoted, is also a "catch-all".

The Washington three year statute has seven subdivisions. As we have seen (Point III(B)), the first one deals only with waste or trespass upon real property. The first two clauses of the second deal with any injury to personal property; and the last clause deals with “. . . any other injury to the person or rights of another not hereinafter enumerated, . . .” The remaining five subdivisions deal with specific types of injuries to “the person or rights”. The Washington Legislature should have foreseen that when a “person or rights” case arose which was not mentioned in one of the five subdivisions of the three year statute after R.C.W. 4.16.080(2), a contention would be made that the last clause of 4.16.080(2) applied instead of the regular “catch-all” two year statute (R.C.W. 4.16.130). Indeed, unless some limiting language be read into the last clause of R.C.W. 4.16.080(2), it is impossible to read it with R.C.W. 4.16.130. Such a case did come along in *Northern Grain & Warehouse Co. v. Holst*, 95 Wash. 312, 163 Pac. 775. This is the first case cited by the trial Court (I-98) in support of its conclusion that the two year statute applied to the cases at bar. In that case *Holst*, a grain inspector, neglected to get a bond from a warehouseman so that Northern Grain could not collect from the warehouse man when he defaulted. The Washington Supreme Court solved the problem created by the Legislature by first deciding that the claim against *Holst* was *indirect*, the direct fault being that of the warehouseman in defaulting. Then the Court went on to hold that where a claim is made of injury to “the person or rights” *not* covered by the five subdivisions of R.C.W. 4.16.080 after

the second subdivision, the injury must be direct to fall within the last clause of 4.16.080(2); if indirect, the claim was limited by the two year provision of 4.16.130. Only that way, said the Court, could the two statutes be read together (95 Wash. 312, 315).

An example of a direct injury within the meaning of the last clause of 4.16.080(2) is *Luellen v. Aberdeen*, 20 Wn. (2d) 594, 148 P. (2d) 849, cited by the trial Court in support of the ruling below. There it was held that a police officer in a mandamus proceeding had suffered a "direct" invasion, so he got the benefit of the last clause.

We do not think either *Holst* or *Luellen* applies to the cases at bar. We are not claiming an injury to "the person or rights" not enumerated in any of the five subdivisions of 4.16.080 after subdivision 2 as in those cases. Instead, we claim that the *first* clause of 4.16.080(2) applies here, because of injury to "personal property". It could hardly be more in point.

Probably the trial Court applied 4.16.130 to the personalty claims at bar because, having decided that no trespass upon real property was made out because the injury, if any, was indirect rather than direct, it thought the same distinction applied to personalty. We are not sure of this for the Court gave no reason for applying 4.16.130 to personalty. In any event, we think nothing could be clearer than appellants claimed injury to their cattle, i.e., to their personal properties. Whether that injury be direct or indirect makes no difference because the first clause of 4.16.080(2) makes no such distinction. The distinction is a Court created one, but it

was never applied by the Washington Supreme Court to personal property; that is to the first clause of 4.16.080 (2). It was created out of necessity (the *Holst* case) and was applied *only* to the last clause of 4.16.080(2); that is, where the "person or rights" are involved and the claim does *not* fall within one of the five subdivisions of 4.16.080 after 4.16.080(2).

Irwin v. J. K. Lumber Co., 119 Wash. 158, 205 Pac. 424, cited by the trial Court, very clearly supports appellants' position here. That case involved an infringement of fishing rights. The Washington Supreme Court held the rights to be personal property and without further ado applied the predecessor of 4.16.080(2).

The trial Court also cited *Clark Lloyd Lumber Co. v. Puget Sound & Cascade Ry. Co.*, 92 Wash. 601, 159 Pac. 774; *Constable v. John P. Duke*, 144 Wash. 263, 257 Pac. 637, and *Noble v. Martin*, 191 Wash. 38, 70 P. (2d) 1064, in support of its two year personalty ruling. The *Clark Lloyd Lumber Co.* case deals with the definition of trespass upon real property and the applicable period of limitations. We quoted from the opinion in that case in Point III(B) above. It has nothing to do with the law of limitations as to personalty. The *Constable* and *Noble* cases are "person or rights" cases. Like the *Holst* case, they are claims not falling within the last five subdivisions of 4.16.080(2). Like *Holst* they involve derelictions of duty and hence indirect injuries. Both do no more than follow the *Holst* case. We have already shown why we think *Holst* does not apply here.

CONCLUSION

The Court should hold on the facts that: (1) solids were within the period of limitations held applicable and up to the time of trial continuously and repeatedly deposited by appellee on appellant's real properties in both cases; and (2) appellee injured appellants' cattle substantially in both cases within the same periods. Having so held on the facts, the Court should hold on the law that (1) the deposit of solids in Washington constitutes a trespass and that (2) the real property and personal property claims are limited by the three year, and not the two year, Washington statute of limitations. The cases should then be remanded with instructions to the trial Court to apply the Washington three year statute of limitations to both types of claims taking into consideration whatever further proof may be in its opinion required. Upon remand, the trial Court should also be instructed to give further consideration to its Conclusion in both cases refusing judgments restraining or controlling appellee's further operations in the light of this Court's holding that a trespass was made out in both cases.

Respectfully submitted,

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No. 14,734

In the

United States Court of Appeals For the Ninth Circuit

ALBERT A. ARVIDSON, et al, *Appellants*,

vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.

W. J. WHITEAKER, et al, *Appellants*,

vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.

APPELLEE'S BRIEF

Appeals from Final Judgments of the United States
District Court for the Western District of
Washington, Southern Division

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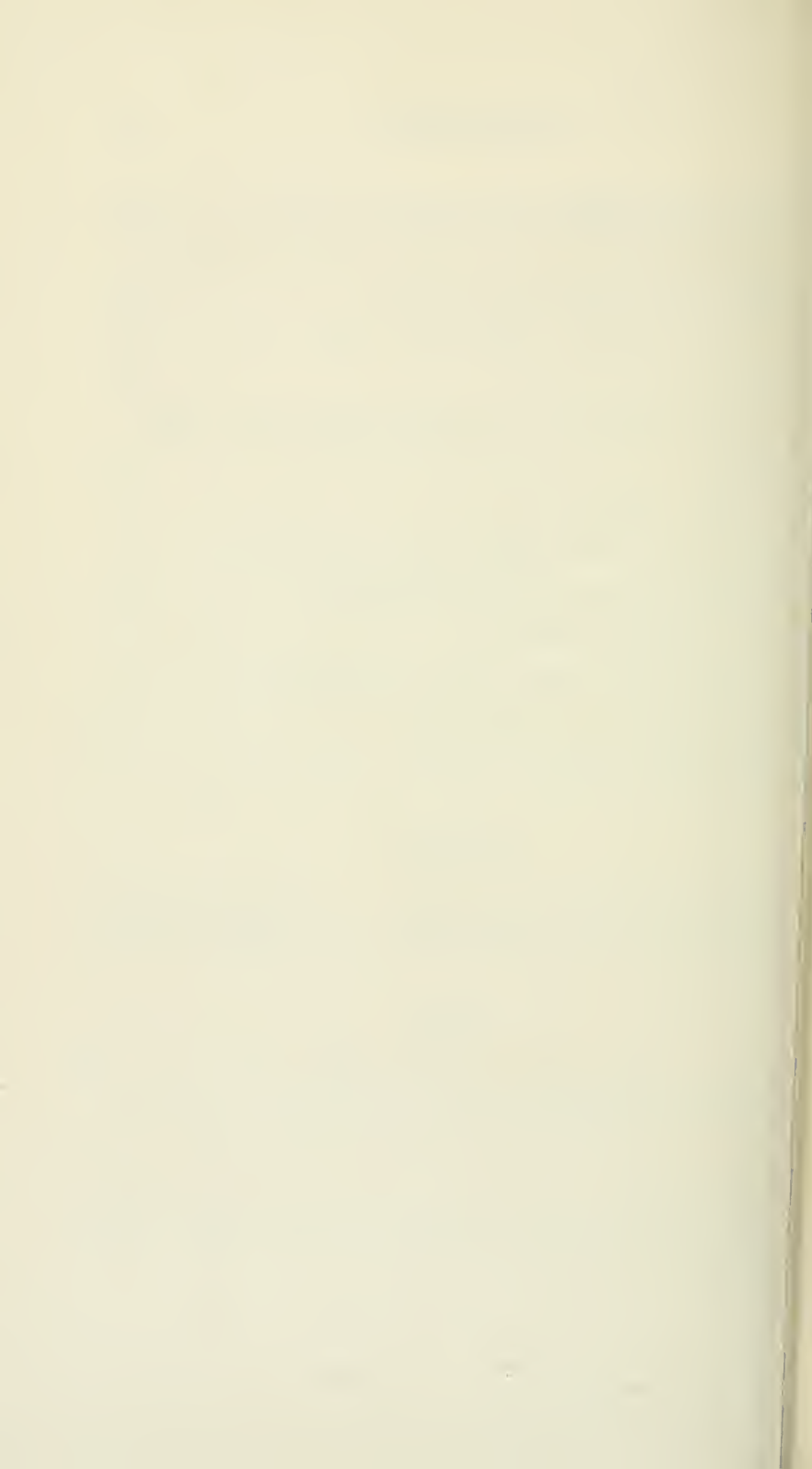
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No. 14,734

In the
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For the Ninth Circuit

ALBERT A. ARVIDSON, et al, *Appellants*,

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APPELLEE'S BRIEF

Appeals from Final Judgments of the United States District Court
for the Western District of Washington, Southern Division

HONORABLE GEORGE H. BOLDT, Judge

STATEMENT OF THE CASES

Because the Statement of the Cases set forth in Appellants' Brief (pp. 2-12) is both incomplete and argumentative, the following statement is submitted to the court:

Arvidson Action. During 1941 and 1942, the Aluminum Company of America constructed the Troutdale aluminum reduction plant for the United States of America and operated the same as lessee from May 20, 1942, to September 7, 1945. Said plant was not operated from September 7, 1945, to September 23, 1946. Appellee commenced operating said plant on September 23, 1946, and operated the same, as a lessee, continuously thereafter except for brief periods when operations were curtailed because of flood conditions and labor difficulties (R-I-14, 20).

No fume control or collection system was present in the plant during the 3½ years it was operated by the Aluminum Company of America. Before appellee commenced operating the plant on September 23, 1946, appellee installed water pipes, spray heads and baffles to precipitate a portion of the gases, fumes and particulates, including fluorides, otherwise passing through the vents in the roof. This system collected approximately 62 per cent of the fluorides which otherwise would have escaped from the plant. On or about June 1, 1949, appellee commenced the construction of a different system at said plant which was completed on or about November 3, 1950. This system consists of hoods for all pots in said plant, the connection thereof to an induced-draft system for the removal of gases, fumes

and particulates from said pots; dust collectors and wash towers for the capture of the gases, fumes and particulates passing into the induced-draft system before the release thereof into the air; and roof scrubbers for the capture of gases, fumes and particulates not drawn into the induced-draft system and for washing of the same. The new system collects approximately 90 per cent of the fluorides which otherwise would escape from the plant (R-I-24-26).

December 6, 1950, the Arvidson appellants filed a complaint in which they alleged that they resided near Camas and Washougal, in Clark County, Washington, and that their personal and real properties situated in said area had been damaged as a result of appellee's operation of the Troutdale aluminum reduction plant (R-I-2-5, 112). The original 24 plaintiffs were engaged in dairy and/or beef operations. The parties stipulated in the pretrial order (paragraphs XXI and XXII, R-I-52, 55) that the claims of 5 additional persons might be considered by the court. At the time that the trial commenced, therefore, 14 farms were involved. At the conclusion of plaintiffs' case the court, upon defendant's motion, dismissed the action as to plaintiffs Lee M. Miller and Della B. Miller for lack of evidence (R-IX-2559).

Some of the appellants owned or leased the farms involved prior to the construction of the Troutdale plant. Others of the appellants commenced occupying their properties only after appellee's operation of said plant commenced (R-I-26-54).

The Arvidson appellants contended (1) that they were entitled to recover \$200,000 in damages for alleged injuries to vegetation and animals and \$350,000 in damages for alleged depreciation in the value of their real properties; and (2) that appellee should be enjoined from operating said plant until measures were taken to prevent the escape of fluorides therefrom (R-I-69, 71).

Whiteaker Action. During 1941 and 1942 appellee constructed the Longview aluminum reduction plant (R-I-140). Appellee commenced operating said plant in 1941 and operated the same continuously thereafter except for a period commencing on June 5, 1947, and ending on March 11, 1948, when operations ceased because of economic conditions (R-I-147-148).

Until 1946 said plant was operated without any fume collection devices. In 1946 and 1947 4 vertical wash towers were installed at each potline building. In 1948 and 1949 4 additional towers were installed at each potline building. These towers were designed to

precipitate the gases, fumes and particulates otherwise emanating from said buildings (R-I-149-151).

November 12, 1952, the Whiteaker appellants filed a complaint in which they alleged that they resided near Longview and Kelso, in Cowlitz County, Washington, and that their personal and real properties situated in said area had been damaged as a result of appellee's operation of the Longview plant (R-I-118-121, 216). The 10 plaintiffs were engaged in operating 4 dairy farms, 3 of which are situated south of Kelso, Washington. The other farm is west of the Longview plant (R-I-152-189). Plaintiffs Rawnsley and Josephson purchased the properties occupied by them prior to the construction of said plant (R-I-172, 184). Plaintiffs Goldsmith have rented the property being occupied by them since 1947 (R-I-181). Plaintiffs Whiteaker purchased the property being occupied by them in 1948 (R-I-152).

The Whiteaker appellants contended (1) that they were entitled to recover \$150,000 in damages for alleged injuries to vegetation and animals and loss of profits and \$175,000 in damages for alleged depreciation in the value of their real properties; and (2) that appellee should be enjoined from operating said plant until measures were taken to prevent the escape of fluorides therefrom (R-I-191, 193).

Pre-Trial Proceedings. August 31, 1953, the court ordered the Arvidson and Whiteaker actions consolidated for pre-trial and trial (R-I-216).

R.C.W. 4.16.080 (R.R.S., Section 159) provides in part as follows:

“Within three years:

“(1) An action for waste or trespass upon real property;

“(2) An action for taking, detaining, or injuring personal property, including an action for the specific recovery thereof, or for any other injury to the person or rights of another not hereinafter enumerated;”

R.C.W. 4.16.130 (R.R.S., Section 165) provides in part as follows:

“An action for relief not herein otherwise provided for shall be commenced within two years after the cause of action accrued.”

Prior to trial, and after argument on the matter, the court held that appellants' claims were subject to the two year limitation period set forth in R.C.W. 4.16.130 (R.R.S., Section 165) (R-I-96-97, 114, 217).

Pre-trial orders were settled prior to the commencement of trial (R-I-14, 140).

Decision of Trial Court. Following the trial of the two actions and on October 19, 1954, the trial court

filed a written opinion setting forth the court's conclusions concerning the issues presented in the actions (R-I-84-102). Thereafter, findings of fact and conclusions of law and judgments were entered in the actions based upon the court's opinion (R-I-102-A-104, 208-A-210). The court found:

(1) Appellee had not trespassed upon appellants' properties;

(2) Appellee's operation of the Troutdale and Longview aluminum plants did not constitute a nuisance; and

(3) Appellants were not entitled to injunctive relief.

QUESTIONS INVOLVED

In the Statement of Points set forth in their Designation of Contents of Record on Appeal and Statement of Points, appellants contend that the findings of fact XXVI, XXVII, XXVIII, XXIX and XXX and conclusions of law III, IV and V in the Arvidson action and findings of fact XVI, XVII, XVIII, XIX and XX and conclusions of law II, III, IV and V in the Whiteaker action were erroneous (R-I-102-C-102-F, 208-B-208-D, 222-224). The questions involved on this appeal are:

(1) Should these actions be remanded to the trial court because the court did not find that fluorides in particulate form emanating from appellee's

aluminum reduction plants settled upon appellant's properties?

(2) Should these actions be remanded to the trial court because the court found that appellants' cattle had not been injured by consuming forage containing fluorine as the result of the settling of fluorides from appellee's aluminum reduction plants upon such forage?

(3) Should these actions be remanded to the trial court because of the court's decision that under the substantive law of the State of Washington a two year limitation period is applicable to claims of damage to real and personal properties assertedly caused by the deposition of air-borne fluorides escaping from an aluminum reduction plant?

While appellants contended in the Statement of Points set forth in their Designation of Contents of Record on Appeal and Statement of Points that the court erroneously found that appellants' real properties did not depreciate in value as a result of appellee's operation of the aluminum reduction plants, appellants do not mention this matter in their brief, and, therefore, no question is involved on this particular point.

SUMMARY OF ARGUMENT

I. Fluorides in particulate form emanating from appellee's aluminum reduction plants did not settle upon appellants' properties. Even if such fluorides did settle upon appellants' properties, remanding of these actions to the trial court would not be warranted.

A. Appellants failed to sustain the burden of proving that fluorides in particulate form settled upon their properties as a result of appellee's operation.

B. Even if appellants proved that fluorides in particulate form emanating from appellee's aluminum reduction plants settled upon appellants' properties, the court must weigh the relative convenience and inconvenience to the parties in determining whether the actions should be remanded to the trial court.

C. The hardships to appellee and the public should injunctive relief be granted exceed the alleged benefits which would accrue to appellants from the granting of such relief.

II. Appellants' cattle were not injured as the result of appellee's operation of the aluminum reduction plants. Even if appellants' cattle were so injured, re-

manding of these actions to the trial court would not be warranted.

A. Appellants failed to sustain the burden of proving that their cattle were injured as a result of appellee's operation of said plants.

1. Appellants failed to sustain the burden of proving that their cattle were injured.

2. Appellants failed to sustain the burden of proving that the proximate cause of any injuries to their cattle was appellee's operation of the plants.

B. Even if appellee's operation of said plants was the proximate cause of injuries to appellants' cattle, the court may not award damages to appellants unless the gravity of the harm to appellants outweighs the utility of appellee's conduct.

C. The utility of appellee's conduct outweighs the gravity of the harm, if any, to appellants.

III. The claims of appellants were subject to a two year limitation period. Even if appellants' claims were subject to a three year limitation period, remanding of these actions to the trial court would not be warranted.

A. The claims of appellants were subject to a two year limitation period.

B. Unless the court finds that appellants were injured as a result of the operation of the plants

determination of the applicable limitation period is moot.

ARGUMENT

I.

Fluorides in particulate form emanating from appellee's aluminum reduction plants did not settle upon appellants' properties. Even if such fluorides did settle upon appellants' properties, remanding of these actions to the trial court would not be warranted.

Fluorides are used in the production of aluminum (R-III-32). "Fluorides" result from the combination of fluorine with other chemical elements. Fluorides are in the form of gases, liquids or solids (R-I-55, 189). Some fluorides escape from the aluminum reduction plants operated by appellee at Troutdale and Longview. Pure fluorine has never escaped from said plants (R-I-55, 189; III-33). Appellants contend that the proof in these actions shows that fluorides in particulate or solid form (as distinguished from gaseous fluorides) emanating from said plants settled upon appellants' properties during the period for which damages are sought.

A. Appellants failed to sustain the burden of proving that fluorides in particulate form settled upon their properties as a result of appellee's operations.

Inasmuch as appellants contend that fluoride particulates from appellee's plants settled upon their properties, appellants have the burden of proving the same. The trial court recognized that appellants failed to establish this fact by a preponderance of the evidence. Because of the state of the evidence on this point, the trial court was unable to determine not only the *character*, but also the *amount*, if any, of the fluorine in the forage growing on the property of appellants which was attributable to appellee's operations. The trial court's comment on this phase of the actions as set forth in a written decision was as follows (R-I-92):

"A fair inference from a full consideration of the evidence on this phase of the case is that some part of the fluorine found in the forage at points within the vicinity of plaintiffs' farms during the period in question in these cases is attributable to fluorides escaping from defendant's plants, but the amount *and character thereof* is a matter of speculation and cannot be determined with any degree of certainty. In all probability some areas in the near vicinity of the plants receive deposits of particulates or solids in a minute and powdery form so fine as not to be observable even by scientific methods. *There is no evidence in the record indicating that direct observation of solid deposits have been made on plaintiff farms or at any other place*

as distant from the plants as the nearest of plaintiffs' farms.

"A further factor complicating the matter is the necessity of using test data from samples gathered at more or less infrequent intervals at scattered points and attempting to draw inferences from *averages* of such data as to particular properties not precisely at a sampling station. It is apparent from the data itself that rather wide variations occur geographically climatically and by season. When all of these matters are considered it can be seen that *any specific finding of fluorine content in forage on the particular property of any plaintiff must very largely if not wholly be a matter of speculation and conjecture.*" (Emphasis added)

Thereafter the trial court entered a finding in the Arvidson action which provided as follows (R-I-102-C):

"All forage contains some fluorine. The court is not able to determine the amount of the fluorine, if any, in the forage growing on plaintiffs' farms which was attributable to the settling upon said farms between December 7, 1948, and November 4, 1953, of fluorides escaping from defendant's Troutdale aluminum reduction plant."

and a conclusion based upon such finding that (R-I-102-F):

"Plaintiffs did not sustain the burden of producing a preponderance of credible evidence to establish * * * (b) substantial fluorine contents in forage attributable to effluents from defendant's plants;"

The court entered a similar finding in the Whiteaker action (R-I-208-B):

“All forage contains some fluorine. The court is not able to determine the amount of the fluorine, if any, in the forage growing on plaintiffs’ farms which was attributable to the settling upon said farms between November 12, 1950, and November 4, 1953 of fluorides escaping from defendant’s Longview aluminum reduction plant.”

and a similar conclusion (R-I-208-D):

“Plaintiffs did not sustain the burden of producing a preponderance of credible evidence to establish * * * (b) substantial fluorine content in forage attributable to effluents from defendant’s plants;”

Of course, the foregoing findings of fact will not be set aside unless “clearly erroneous.”

Rule 52 (a), Federal Rules of Civil Procedure

“Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.”

The burden is upon appellants to show that these findings are “clearly erroneous.” The burden is upon him who attacks a finding to show that it is “clearly erroneous.”

Grace Bros. v. Commissioner of Internal Revenue
(CA 9, 1949) 173 F. (2d) 170, 174

Findings of fact are not "clearly erroneous" unless unsupported by substantial evidence or clearly against the weight of the evidence or induced by an erroneous view of the law. The mere fact that on the same evidence the appellate court might reach a different result does not justify it in setting these findings aside. The appellate court does not consider and weigh the evidence de novo.

2 Barron and Holtzoff, Federal Practice and Procedure (1950), p. 834

In considering whether these findings are "clearly erroneous," the appellate court looks only to the evidence most favorable to said findings and such reasonable inferences as may be drawn from such evidence.

Lewis Mach. Co. v. Aztec Lines (CA 7, 1949) 172 F. (2d) 746

A summary of the evidence bearing directly on the matter in dispute follows:

Arvidson Action. The best evidence as to whether or not any fluorides were deposited upon appellants' real properties during the period for which damages are claimed are vegetation samples taken during the period and analyzed for the purpose of determining the fluorine content of the same in parts per million.

“Parts per million is a way of expressing extremely small amounts. If you were to express it in percentage you would have a decimal point and a lot of zeros. One part per millions means one pound in a million pounds, one gallon in a million gallons, one cubic foot in a million cubic feet, one unit of whatever you express to it. The expressable unit here is on a weight to weight basis and you could express it, one part per million could mean one milligram in a million milligrams, or one pound in a million pounds, one part in a million, literally as it indicates.” (R-III-43)

The only vegetation samples taken on appellants' properties and introduced in evidence at the trial were those taken by appellee. These samples were taken from appellants' farms as examinations of appellant's cattle were made. The following samples taken on the following dates upon farms owned by the following appellants, upon analysis, showed the following amounts of fluorine:

<i>Appellant</i>	<i>Sample Date</i>	<i>Type</i>	<i>Fluorine Content (Parts Per Million)</i>	
Albert A. and Cherie Arvidson	10-26-53	Grass near barn.	21	
		Grass in pasture S of barn.	16	(Ex. 1492-A)
Brandt	10-28-53	Grass.	22	(Ex. 1492-D)
Depoe	10-28-53	Grass in pasture E of barn.	13	
		Grass 300 yards NW of barn.	9	(Ex. 1492-E)
		Grass W of house	8	
Ford	10-26-53	Grass from pas- ture SW of barn.	13	
		Grass in barnyard fence row.	15	(Ex. 1492-B; R-VII-1643)
Norelius	10-26-53	Grass in pasture N of barn.	9.7	
		Grass in pasture SE of barn.	12	(Ex. 1492-C)
Robson	10-28-53	Grass near barn.	11	
		Grass in pasture NW of barn.	8.5	
		Grass in pasture SE of barn.	12	(Ex. 1492-H)
		Grass in pasture ½ mile S of barn.	12	
Seekins	10-28-53	Grass in pasture W of barn.	19	(Ex. 1492-I)
Stauffer	11-12-53	Field SE of barn. Hill 200 yards E of barn.	12	
		Field 250 yards E of barn.	14	
		Field 350 yards NW of barn.	11	(Ex. 1492-J)
		Field 50 yards W of barn.	14	
			15	
Johnston	10-28-53	Grass from pas- ture S of barn.	9.7	(Ex. 1492-F)
		Grass from pas- ture W and NW of barn.	11	

The fluorine values set forth in the foregoing table range from 8 to 22 parts per million. These values do not establish that the fluorine present was attributable to the settling of air-borne fluoride particulates. Harold Zeh, the chief chemist for appellee's Troutdale and Longview plants, testified that values as high as 20 to 25 parts per million could be considered as normal (R-III-42, 72). He referred to samples taken by his staff to substantiate this opinion (Ex. 1490, 1640; R-III-73). This opinion was also confirmed by the sampling of forage by personnel from the Western Washington Experiment Station at Puyallup. Location G was the control (i.e. normal) area with respect to sampling in the vicinity of the Troutdale plant (R-III-132). Yet the forage in this area at times contained 17-18 parts per million of fluorine (Ex. 20, Location G). Sampling at Locations 1 and 3 was for control purposes in the Longview area (R-III-188-190, 214). Some of the samples from Location 1 ran as high as 22-24 parts per million (Ex. 520, Location 1).

The fluorine content of the urine of cattle indicates whether or not the fluorine content of forage is above normal (R-VIII-1969; IX-2321). Urine which has a fluorine content of 5 to 10 parts per million or less indicates that the animal from which the sample is taken has been grazing on forage containing a normal

amount of fluorine (R-VIII-2017; IX-2355). The following table sets forth the *maximum* fluorine content of the only urine samples taken from animals in herds owned by the following appellants on the following dates:

<i>Appellant</i>	<i>Date of Sample</i>	<i>Maximum Fluorine Content (Parts Per Million)</i>	
Albert A. and Cherie Arvidson	10-26-53	3.0	(Ex. 1492-A; R-III-1642)
Baker	8-25-53	5.7	(R-I-29-30)
Brandt	10-28-53	3.7	(Ex. 1492-D; R-III-1645)
Depoe	10-28-53	3.0	(Ex. 1492-E; R-III-1646)
Ford	10-26-53	4.3	(Ex. 1492-B; R-III-1643)
Isbister	8-25-53	2.4	(R-I-38)
Norelius	10-26-53	2.3	(Ex. 1492-C; R-III-1644)
Robson	10-28-53	2.7	(Ex. 1492-F; R-III-1648)
Seekins	10-28-53	5.9	(Ex. 1492-I; R-III-1649)
Stauffer	11-12-53	2.3	(Ex. 1492-J; R-III-1649)
Johnston	10-28-53	2.1	(Ex. 1492-F; R-III-1647)
Raymond A. and Blanche Arvidson	9-3-53	8.3	(R-I-54-55)

The highest fluorine content found in any of the hundreds of samples taken from August 25, 1953, to November 12, 1953, was 8.3 parts per million, which is well

within the aforesaid limits of 5 to 10 parts per million established by expert testimony without contradiction.

The foregoing analyses of urine and forage samples show that at least for a certain period in 1953 no fluorides were being deposited upon the farms of the appellants referred to above. Whether or not fluorides settled upon appellants' farms during other times is not shown by the record in view of appellants' failure to introduce proof of analyses of vegetation growing on each of the farms. This proof is not supplied by the periodic sampling of vegetation by appellee and by personnel from the Western Washington Experiment Station. Sampling was conducted by the latter institution during the period for which damages are claimed (R-I-64-67). However, almost all the samples taken were near the north shore of the Columbia River and far distant from appellants' properties. None of the samples taken by appellee during the same period was on properties occupied by appellants except for those hereinbefore referred to (R-I-56-63).

Appellants' awareness of this deficiency in proof is shown by the following statement (Appellants' Brief p. 15):

"As to Troutdale, appellee maintained 13 stations on the Washington side of the Columbia. Had the results obtained been obtained on appellants' farms instead of on the stations, the results would

have been comparable (III-79). Later Mr. Zeh explained that the testing stations had been selected by agreement for the trial because they bracketed the farms and that the station results obtained were comparable to results that would have been obtained on the farms if the distances between the two were reasonable (III-122)."

The record does not show what distance is "reasonable." Furthermore, Mr. Zeh testified on recross examination that by "comparable" he meant "the nearest comparison that you can make" (R-III-124). It does not follow, therefore, that because a sample from a particular station has a fluorine content in excess of normal the vegetation on the farm nearest to said station occupied by one of the appellants has an above normal fluorine content. Even though the samples taken and analyzed by appellee and by Western Washington Experiment Station were of some significance in this respect, on which of the farms involved herein did fluorides settle? Furthermore, were the fluorides foreign matter, i.e. particulates, or were they gaseous in nature? The state of the evidence on this point was such as to leave the trial court without a guide.

Whiteaker Action. Appellee did take periodic forage samples from the Rawnsley farm during the period for which damages are claimed. Similar samples were taken upon the Rawnsley farm and also the Whiteaker farm by personnel from the Western Washington

Experiment Station. Some of the samples so taken contained an above normal amount of fluorine (R-I-156-164, 175-179).

The only forage and urine samples taken on the Goldsmith farm were by appellee on October 19, 1953. The highest fluorine content of the urine samples was 5.1 parts per million (Ex. 1624; R-VII-1651). The fluorine content of the forage was 9.4 parts per million. Each of these results is within the normal range previously referred to (*supra*, p. 18).

No samples of forage were taken on the Josephson property. However, on August 4, 1953, appellee took urine samples from 12 head of cattle. The highest result was 5.3 parts per million (R-III-186). This, of course was within the normal range.

As in the Arvidson action, the foregoing evidence is the only evidence directly bearing on the question as to whether or not fluorides were deposited upon appellants' properties. The situation is the same as in the Arvidson case. The deficiency in proof leaves the matter subject to conjecture and speculation.

B. Even if appellants proved that fluorides in particulate form emanating from appellee's aluminum reduction plants settled upon appellants' properties, the court must weigh the relative convenience and inconvenience to the parties in determining whether the actions should be remanded to the trial court.

If the appellate court should differ with the trial court and conclude that particulate fluorides from appellee's plants settled upon appellants' properties (thus deciding that the findings of fact referred to in I. A. hereof are "clearly erroneous"), appellants contend that a trespass would be proved and the actions should be remanded for further consideration of injunctive relief (Appellants' Brief, p. 11). This contention is not sound.

If the court concludes that the settling of such particulate fluorides constituted a trespass (as incorrectly contended by appellants in their brief, p. 89), the court must apply the doctrine of comparative injury and balance the conveniences and inconveniences of the parties in order to determine the propriety of injunctive relief. Even though there is a continuing trespass, equity will weigh the relative convenience and inconvenience to the parties in determining whether injunctive relief should be granted.

28 Am. Jur., Injunctions, Section 141, p. 330

“Injunction against a trespass is sometimes refused because the hardship, injury, or inconvenience which it would cause the defendant is out of all proportion to the benefit it would bring to the plaintiff, and the courts have, in some instances, refrained from restraining the commission of a trespass where the injunction would result in little or no benefit to the plaintiff, and would cause great inconvenience and expense to the defendant.”

Clifton Iron Co. v. Dye (1889) 87 Ala. 192, 6 So. 192, 193

The effect of an injunction upon the public interest must also be considered in determining the propriety of injunctive relief against a continuing trespass.

***Minto v. Salem Water, L. & P. Co.* (1926) 120 Or. 202, 219 250 Pac. 722**

“Even though there has been a continuing trespass and a multiplicity of actions would result if the plaintiff were obliged to seek redress at law, equity will not raise its restraining arm if, by so doing, great and irreparable injury might result to the public.”

Clifton Iron Co. v. Dye, supra.

C. The hardships to appelle and the public should injunctive relief be granted exceed the alleged benefits which would accrue to the appellants from the granting of such relief.

The court entered the following finding in the Arvidson action (R-I-102-D):

“Defendant’s operation of the Troutdale aluminum reduction plant did not result in an unreasonable nor intentional interference with plaintiffs’ use and enjoyment of properties. The utility of defendant’s operation of said plant and the importance of the same to the economy and security of the nation far outweigh (sic) plaintiffs’ injuries, if any.”

and the following finding in the Whiteaker action (R-I-208-C):

“Defendant’s operation of the Longview aluminum reduction plant did not result in an unreasonable nor intentional interference with plaintiff’s use and enjoyment of properties. The utility of defendant’s operation of said plant and the importance of the same to the economy and security of the nation far outweigh plaintiff’s injuries, if any.”

These findings were grounded in part on the fact that a decree making further operation of the plants contingent upon the elimination of air-borne fluorides would render further operation impossible and result in a discontinuance of production of aluminum thereat. The continued production of aluminum at said plants is of vital importance to the United States, especially in view of appellee’s agreement to supply it with 200,000,000 pounds of aluminum for a 5 year period (Ex. 1322).

Moreover, the value of these plants to the communities in which each is located is obvious from the following facts which were received in evidence (R-VII-1680-1682):

“* * * that said records show the following information with respect to the cost of operating the fume control system at Longview for the year 1948, \$20,575.05; for the year 1949, \$86,002.66; for the year 1950, \$121,330.04; for the year 1951, \$18,091.08; for the year 1952, \$117,399.75; for the ten months' period ended October 31, 1953, \$126,514.46, or a total from January 1, 1948, until October 31, 1953, of \$589,931.34; that the operating costs for the fume control system at Longview during the years 1946 and 1947 are not identifiable for the reason they were not kept separate from the pot room operating expenses during those two years; that the cost of operating the fume control system of the Troutdale Aluminum Reduction Plant for the year 1946 was \$2,830.02; for the year 1947, \$43,259.71; for the year 1948, \$162,756.90; for the year 1949, \$61,865.83; for the year 1950, \$129,528.83; for the year 1951, \$292,729.11; for the year 1952, \$304,801.36; for the ten month period ended October 31, 1952, \$279,795.58, for a total commencing in 1946 and ending October 31, 1953, of \$1,277,567.34; that the number of employees presently employed at the Longview Aluminum Reduction Plant is five hundred thirty-four; that the number of employees, that is salary and hourly, presently employed at the Troutdale Aluminum Reduction Plant is eight hundred fifteen; that the average annual payroll at the Longview plant is \$2,522,200.00; that the average annual payroll at the Troutdale plant is \$4,010,700.00; that the Reynolds Metal Company, the defendant herein, has paid the following real property and personal property tax

as a result of the Longview operation for the year 1948, \$118,204.15; for the year 1949, \$119,103.32; for the year 1950, \$63,246.29; for the year 1951, \$112,481.04; for the year 1952, \$88,840.32; estimated for the year 1953, \$117,153.00 for a total during the period referred to, 1948 to and including 1953, at \$619,028.12.

“That the real property and personal property taxes paid by the defendant as a result of the operation of the Troutdale Aluminum Reduction Plant has been as follows for the year 1948, \$120,901.10; for the year 1949, \$162,090.83; for the year 1950, \$197,079.41; for the year 1951, \$380,960.27; for the year 1952, \$415,027.25; estimated 1953, \$394,568.00, or a total during the period referred to commencing in 1948 and extending into the year 1953, of \$1,670,626.86.

“That the plant investments including the fume control system at Longview is in the amount of \$15,942,560.00; that the similar investments at the Troutdale plant is \$21,887,359.00; that the latter figures consists of the original construction costs to the United States Government and the additions made by the defendant Reynolds Metals Company. The actual purchase price of the Troutdale Aluminum Plant is \$9,288,708.00.”

It is thus evident that the advantages accruing from appellee's continued operation of these two plants far overshadow the trespass which appellants contend appellee committed.

II.

Appellants' cattle were not injured as the result of appellee's operation of the aluminum reduction plants. Even if appellants' cattle were so injured, remanding of these actions to the trial court would not be warranted.

Appellants contend in their brief (p. 28) that their cattle "were substantially injured in fact" by appellee and that if the appellate court agrees with this contention the actions should be remanded to the trial court for determination of the quantum of damages. These contentions have no basis in fact or law.

A. Appellants failed to sustain the burden of proving that their cattle were injured as a result of appelle's operation of said plants.

In the Arvidson action the court found (R-I-102-D):

"Plaintiffs' cattle were not injured as a result of defendant's operation of its Troutdale aluminum reduction plant from December 7 1948, to November 4, 1953."

In the Whiteaker action the court found similarly (R-I-208-B).

The court concluded in both actions (R-I-102-F, 208-D)

"Plaintiffs did not sustain the burden of producing a preponderance of credible evidence to

establish (a) fluorine content in the forage on their lands in amounts above non toxic limits; (b) substantial fluorine content in forage attributable to effluents from defendant's plants; or (c) that plaintiffs' lands or cattle sustained fluorine damage in particulars and amounts that can be determined with reasonable or any certainty."

Appellants take issue with these findings of fact and conclusions of law.

In their brief appellants have proceeded on the theory that, if they can establish that the cattle of some of the appellants were injured by reason of appellee's operation of the two plants, then they establish appellee's liability to all appellants. This theory apparently is based upon the assumption that the actions are representative in character. The unsoundness of such assumption is apparent. The claim of each appellant must stand upon its own bottom as far as proof of liability and damages is concerned, just as though each appellant were proceeding in an individual action. This is especially true when, as here, there are differences between the individual operations involved such as geography, size, agricultural practices, types of herd, etc.

The following review of the evidence is not restricted to those appellants selected by appellants' counsel and indicates that the burden has not been satisfied as to

proof of injury and causation with respect to any of the claims.

1. Appellants failed to sustain the burden of proving that their cattle were injured.

a. Fluorine in normal forage.

The alleged cause of the alleged injury to appellants' cattle is reputedly forage containing a toxic amount of fluorine. It has already been shown that all forage contains some fluorine and that the amount of such fluorine may be as high as 25 parts per million (*supra*, p. 18).

b. Tolerance level of cattle.

If the court determines that the fluorine content of the pastures of some of the appellants was higher than normal during certain periods, the ultimate inquiry must be as to whether or not the amounts of fluorine in the forage were sufficient to injure an animal consuming the same. The levels testified to at the trial vary. Mr. Miller, appellants' witness, testified that the tolerance level was 30 parts per million of fluorine (R-III-233-234).

The most detailed testimony on this subject was that of Dr. Paul H. Phillips, Professor of Biochemistry at the University of Wisconsin, a specialist in the field of nutrition, and chairman of a subcommittee of the

National Research Council of the United States responsible for writing on fluorosis in livestock (R-VIII-1983, 1986, 1989). In 1928, the University of Wisconsin commenced an experiment to determine the effect of long-time feeding of rock phosphate fluorine to cattle (R-VIII-1989). Dr. Phillips became actively associated with the experiment in 1930 and carried it to completion in 1933 (R-VIII-1989, 1993). Referring to the conclusions drawn from this experiment, Dr. Phillips testified (R-VIII-1996-1998):

“Q. (Continuing) Would you advise the Court, Doctor, what the results of that experiment were with respect to lots four, five and six particularly on the growth of the animals that were involved as revealed by the experiment when it was concluded in 1933?

“A. Well, from the data that we obtained the growth was not impaired by any of these levels. That is, they were able to tolerate the fluorine in the amounts given in the form of rock phosphate without any marked effect upon growth.

“Q. That would be true both with respect to lot four and also lots five and six, is that right?

“A. That is right.

“Q. All right. Then what about the effect on milk production?

“A. There was no effect upon milk production in lot four. A slight reduction in lot five and a definite and marked decrease in lot six.

“Q. And lot four I believe you testified was the group that was receiving approximately eighty

parts per million of fluorine in the form of rock phosphate, is that right?

"A. Yes, sir.

"Q. Did you observe any signs of lameness or stiffness in any of these groups?

"A. In lot six there was lameness and stiffness.

"Q. I take from your answer there was no lameness or stiffness in lots four and five, is that right?

"A. There was definitely none in lot four. Lot five may have had one animal that was stiff.

"Q. Were you able to make any observations concerning the impact of these levels of fluorine in the form of rock phosphate upon the reproductive capacities and experience of the animals?

"A. There was no effect as far as reproduction was concerned, that is the process of reproduction itself."

Dr. Phillips also testified that rock phosphate fluorine is half as toxic as sodium fluoride, and that the tolerance level as shown by the 1928-1933 experiment was, therefore, 30 to 40 parts per million of sodium fluoride fluorine (R.-VIII-1995, 2001). In 1951, Dr. Phillips commenced a new experiment involving the ingestion of sodium fluoride by cattle, which he characterized as

"one of the more soluble sodium salts and it is probably one that is causing damage in the industrial areas of the United States." (R.-VIII-2000)

The cattle involved in this experiment were given varying amounts of sodium fluoride fluorine up to 50 parts per million (R-VIII-2003). His observations at the time of the trial are contained in his testimony, which may be summarized as follows (R-VIII-2007):

“Q. Will you state for the Court the observations that you have made up to the present time with respect to the effect upon the animals involved of the ingestion of the amounts of fluorine you have testified to?

“A. Well, you must realize that this experiment is still in progress and that a definite report can only be a progress report at this moment.

“First I think there has been no effect upon the mature body weight or the maintenance of body weight of these adult cattle or cattle at least in their late stages of growth just before reaching maturity. There has been no depreciation or reduction in milk production at the present moment. The calves are approximately the same in all lots indicating that reproduction is not interfered with by these levels of fluorine supplements.”

As a result of Dr. Phillips' testimony, the evidence is not in dispute that cattle may consume at least up to 50 parts per million of fluorine without injury.

Dr. Phillips' conclusions were confirmed by the work of Dr. Harold J. Schmidt, a veterinarian called by appellee. Dr. Schmidt has practiced near Modesto since 1941 and has operated his own dairy farm since

1945 (R-VII-1684). His first contact with fluorosis in cattle occurred during the operation of an aluminum reduction plant near Modesto by the Aluminum Company of America from 1943 to 1944 (R-VII-1684-1685). He has examined cattle for fluorosis at the request of the Stanford Research Institute (R-VII-1686). Since 1949, Dr. Schmidt has conducted a controlled feeding experiment involving five groups of dairy cattle. One group is for control purposes and receives approximately 7 parts per million of fluorine. The other four groups receive 30, 45, 60 and 75 parts per million, respectively, of sodium fluoride fluorine (R-VII-1689-1692). Sodium fluoride was selected as being "the most toxic inorganic solid available" (R-VII-1694). Dr. Schmidt made the following observations concerning these cattle (R-VII-1695-1696, 1698-1699):

"A. I might say that perhaps—our experiment is not completed and we are reserving conclusions until we complete the project, but I might add so far as we have gone from the standpoint of body weight and milk production, there has been no difference observed in any of the groups. We had a slight exostosis and thickening of the metatarsal bones in three of the animals of the high group.

"Q. That would be seventy-five?

"A. Seventy-five parts per million, and we have a very slight unthriftness that is not too definite, but I think it is fairly distinct in the high group.

"Q. That, once again, would be the seventy-five parts per million group.

"A. Yes.

"Q. But apparently as far as all of these groups are concerned, there has been no noticeable effect on milk production to date, is that right?

"A. That is right. I might add that the teeth do show definite fluoride effects.

"Q. What do you mean by 'fluoride effects' Doctor?

"A. The enamel of the teeth are (sic) effected at the period of formation and that approximates a time nine to twelve months prior to eruption, and we have observed in the thirty parts per million group a very slight mottling and in some cases a very slight stain of the incisors teeth that were forming during the period of development. * * *

"Q. All right. How has the production of the control herd compared with the production of other animals that are similarly on DHIA test in your county?

"A. We have completed three lactation periods and we are nearly through with the fourth lactation period. I might add that in Oregon State that in arriving at a herd average all animals in the herd are included and our animals of course, we are not maintaining culling practice. We are keeping all the animals in, but as heifers they were very close to the average of the county. At the present time they are well above the average. In fact, this year they will be in, probably in the top ten per cent of the county."

This experiment thus indicates that dairy cattle may ingest up to 75 parts per million of fluorine without injury.

c. Cheldelin testimony.

Appellants sought to detract from the conclusions reached by Drs. Phillips and Schmidt through their controlled feeding experiments by the testimony of Dr. Vernon H. Cheldelin of Oregon State College. His testimony on this point may be summarized as follows:

(1) The fluorides emanating from aluminum plants are inorganic (R-IX-2519).

(2) Sodium fluoride is inorganic (R-IX-2517).

(3) Air-borne fluorides from aluminum plants are taken into the internal structure of pasture grasses (R-IX-2516-2517).

(4) Growing plants convert inorganic fluorides into organic fluorides (R-IX-2519).

(5) One of these organic fluorides would be fluoro acetate (R-IX-2524)

Dr. Cheldelin then concluded that the controlled feeding experiments involving sodium fluoride are not "relevant" to the inquiry concerning the damage to cattle from air-borne fluorides (R-IX-2534).

Appellee concedes the validity of points (1) and (2) set forth above. As to point (3), the witness included all fluorides, both particulate and gaseous. This is in conflict with the testimony of Mr. Zeh, who, in answer to a question from appellants' counsel, indicated that only gaseous fluorides would be taken into a plant (R-III-100).

As to the fourth proposition, Dr. Cheldelin was the only witness willing to take a stand on the subject. His opinion was not based upon any experimental work in evidence, documentary or otherwise, and was entirely speculative. He admitted that he had not experimented with vegetation to determine whether or not his conclusions had any validity (R-IX-2544). The speculative character of his opinion is apparent from the testimony of the following expert witnesses on the same subject who indicated there was no proof concerning the same:

- (1) Zeh (R-III-101)
- (2) Miller (R-III-233)
- (3) Compton (R-V-1016)
- (4) Allmendinger (R-III-200)

All four of these men have spent years of research in connection with the deposition of air-borne fluorides on vegetation. Dr. Cheldelin, on the other hand, has engaged in no experiments with pasture grasses, nor conducted fumigation experiments with fluorine gases (R-IX-2543-2544).

With respect to the fifth proposition set forth above, Dr. Cheldelin testified that the German publication which he cited as containing evidence of the conversion by pear and cherry leaves and spruce needles of inorganic fluorides to organic fluorides did not indicate

the nature of the type of organic fluoride (R-IX-2519-2520). He could cite only one tropical plant as evidence that fluoro acetate existed in plant life (R-IX-2520-2521). At the same time, he testified as follows:

(1) All forage contains some fluorine (R-IX-2542).

(2) This fluorine in forage is derived from the soil (R-IX-2542).

(3) The identity of the fluorine in forage is not known, but he would expect fluoro acetate to be present (R-IX-2545, 2547, 2554-2555).

(4) Scientific techniques are not available to distinguish between the amount of fluoro acetate he would expect to find under normal conditions and the amount of fluoro acetate attributable to the conversion of inorganic air-borne fluorides into organic fluorides (R-IX-2555).

(5) It is impossible presently to determine whether pasture grass containing 200 to 500 parts per million of fluorine because of the deposition of air-borne fluorides would contain a lethal amount of fluoro acetate (R-IX-2557).

This testimony indicates that his criticism of the controlled feeding experiments involving sodium fluoride as not reflecting what is occurring in areas subject to the deposition of air-borne fluorides is without foundation. The fact that these experiments do create effects similar to those occurring in the field is borne out by the testimony of Dr. Schmidt (R-VII-1731, 1732-1733).

“Q. Well, maybe I can put it this way. Let’s assume that the cow that is eating grass near an aluminum plant is getting thirty parts per million in the form of hydrofluoric acid from the grass and you are feeding your thirty parts per million in the form of a salt such as sodium fluoride, aren’t your conclusions based on the assumption that regardless of the kind of fluorine the cow consumes, that you will get identical results with the same amount of actual fluorine?

“A. I am basing my conclusions on what I see, and I see the same conditions in animals that are in an area of an aluminum plant or a steel plant or a fertilizer plant, as I have in the animals that I have on sodium fluoride in my feed experiment.

“THE COURT: He said he observed it in the field in connection with plants and also the results of his test experiments and to him he sees no difference.”

The trial court accepted “at substantially full face value” the conclusions which Dr. Phillips and Dr. Schmidt derived from their controlled feeding experiments and discounted Dr. Cheldelin’s opinions (R-I-93-94):

“The court was much impressed with the ability, scientific attitude and credibility of Dr. Paul H. Phillips, Professor of Biochemistry at the University of Wisconsin, and Dr. Harold J. Schmidt of Stanford University Research Institute. Each is one of the very few top authorities in his scientific field and both testified in a frank and fair manner giving the impression of scientific candor and objectivity. These men have given special attention over a long period of time to the effects of fluorine in-

gestion in cattle and have personally conducted elaborate scientific experiments with extensive herds devoted exclusively to such purpose. Both Dr. Phillips and Dr. Schmidt testified without reservation that cattle could and actually had ingested fluorine over considerable periods in amounts far exceeding the maximum shown to have been available for ingestion by plaintiffs' animals without injurious effect either as to physical condition or milk production capacity. Plaintiffs' witness, Professor Cheldelin, testified that in his opinion inorganic fluorine, such as found in the effluence from defendant's plants, after deposit on vegetation is absorbed in the plant cells and therein converted to organic fluorine developing thereby much more highly toxic powers; but he admitted that such theory has never been demonstrated or proven by actual experiment and, at the present stage of science, is merely a matter of theory not endorsed by scientists generally. The court accepts the testimony of Dr. Phillips and Dr. Schmidt at substantially full face value and in doing so cannot but conclude that on the issues covered by their testimony, plaintiffs have wholly failed to sustain the burden of proof resting on them in these cases."

d. Veterinarian testimony.

The opinions of competent veterinarians who have examined cattle claimed to have been damaged by fluorosis is another means of determining whether or not such claims have merit. Appellee called as expert witnesses Drs. Chapman, Phelps and Garlick, each of whom had examined almost every herd involved in these actions. Each of these men has extensive experi-

ence in employing the diagnostic techniques required to determine whether injury or damage from fluorosis has occurred.

Dr. Chapman's initial contact with this matter occurred as the examining veterinarian for Oregon State College in 1948 and 1949 in connection with its study of fluorosis in cattle (R-VIII-2085-2087). Dr. Garlick had first encountered the problem in 1942 or 1943 near Tacoma, and has specialized in the use of teeth of cattle for diagnostic purposes (R-VII-1855). Dr. Phelps has been president of both the Oregon State Veterinary Medical Association and also the Washington State Veterinary Medical Association. His experience has been similar to that of Dr. Garlick's (R-VIII-2273, 2275).

Appellants called Drs. Keller and Guard. Dr. Keller graduated from Washington State College in 1945 and practiced in the Camas-Washougal area from 1945 to 1952 (R-III-242). He made his first diagnosis of fluorosis in 1946 (R-III-303).

Dr. Guard commenced private practice one year later than Dr. Keller at Longview, Washington (R-VII-1744). Neither he nor Dr. Keller attempted to obtain supporting laboratory data for their diagnoses of fluorosis (R-III-303; VII-1799). Dr. Guard testified that "fluorine staining" on the teeth of some cattle in a

herd always signified toxic injury to the herd, and that such herd had no commercial value except for salvage purposes (R-VII-1809, 1826, 1829). Dr. Keller disagreed with this view, for he testified that a *majority* of the animals would be suffering (R-III-300, 301). He also has indicated that the effect of fluorine ingestion on teeth does not necessarily mean injury to the animal (R-VIII-2093-2094):

“Fluorine has a deleterious effect on tooth development even in a dose that has no other injurious effect.”

Referring to the five veterinarians who examined appellants' cattle and testified concerning the condition of the same, the trial court stated (R-I-90):

“Each of the veterinarians examined all of the dairy cattle in plaintiffs' herds and cattle urine was tested for fluorine by defendant's veterinarians at various intervals during the period in question; plaintiffs' veterinarians found a variety of physical conditions in the cattle which they considered evidence of fluorine ingestion and damage resulting therefrom. Defendant's veterinarians accounted for many of the ailments and defects referred to by ascribing them to other causes and categorically were of the opinion that none of the plaintiffs' cattle had suffered injury or damage in any respect by reason of fluorine ingestion, testifying that the urine analysis supported such opinion. The court was favorably impressed with the ability, integrity and thoroughness of defendant's veterinarians and, to say the least, is of the opinion that there is no preponder

ance in favor of the plaintiffs in the evidence of the veterinarians."

e. Arvidson action.

The following review of the proof relating to the Arvidson appellants measured by the standards previously referred to indicates that the claims of damage to cattle are without merit.

(1) **Albert A. Arvidson.** No reference is made to these appellants in Appellants' Brief (Point II). The highest fluorine content in the forage samples taken on their property was 21 parts per million (*supra*, p. 17). This is normal, or at least close to normal (*supra*, p. 18). The highest fluorine content of urine samples taken from these appellants' cattle was 3 parts per million. This was within the normal range (*supra*, p. 18).

The following veterinarians examined appellants' herd for fluorosis on the following dates:

<i>Veterinarian</i>	<i>Date of Examination</i>
Garlick	7-12-51
Phelps	7-12-51 10-26-53
Chapman	10-26-53

Drs. Chapman, Garlick and Phelps found no evidence of injury or damage in examinations over a two year period (R-VIII-2096; R-VII-1880; R-VIII-2282-2283,

2288). The diagnoses of these three veterinarians is confirmed by the forage and urine samples referred to above. Further confirmation is derived from the fact that appellants could not tell whether there was a drop in milk production (R-V-1064). Appellants contend that increased fluorine intake causes a decrease in milk production (Appellants' Brief, p. 28).

The credibility of Mr. Arvidson is extremely questionable in view of his admission on the witness stand that he followed the practice of filing personal property returns in which he falsified the number of cattle on hand on the critical dates (R-V-1076-1077).

(2) **Baker.** No forage samples were taken from the Baker properties. The highest amount of fluorine recovered from urine samples was 5.7 parts per million, which, of course, is a normal amount (*supra*, p. 19).

The following veterinarians examined appellants' cattle on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Phelps	9-20-50 (R-VIII-2281)
Phelps	7-12-51 (R-VIII-2282-2283)
Garlick	7-12-51 (R-VII-1881, 1884)
Phelps	8-25-53 (R-VIII-2285-2286)
Chapman	8-25-53 (R-VIII-2088-2089)

The examinations of these three veterinarians covered a three year period. None of them made a diagnosis

that the animals in the herd during this period were suffering from fluorosis. The urine samples confirm their opinions. Apparently, these appellants also experienced no appreciable variation in milk production. Production was "down a little in 1949 or 1950," but started up again thereafter (R-IV-682-683).

(3) **Brandt.** No reference is made to these appellants in Appellants' Brief (Point II). The highest fluorine content of forage samples taken on their farm was 22 parts per million, which is normal or close thereto (*supra*, p. 17). The urine samples with the most fluorine contained a normal amount, 3.7 parts per million (*supra*, p. 19).

The Brandt cattle were examined by the following veterinarians on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Garlick	7-12-51 (R-VII-1884, 1887)
Phelps	7-12-51 (R-VIII-2282-2283)
Phelps	10-28-53 (R-VIII-2288-2289, 2295)
Chapman	10-28-53 (R-VIII-2105-2106)

None of these veterinarians who examined the cattle over a two year period diagnosed the cattle as suffering from fluorosis. Their opinions in this respect are confirmed by the urine and forage samples.

Mr. Brandt characterized the condition of his herd as follows (R-V-929):

“Q. I see. What have you to say about the condition of your herd right now? Is it in good condition, good flesh and so forth, or otherwise?”

“A. Well, they look all right to me.”

Dr. Keller, one of appellants’ veterinarians, admitted that his examination of the teeth of the animals in the herd disclosed only one animal with staining attributable to fluorine ingestion after December 7, 1948, and this animal was “on the borderline” (R-III-318).

(4) **Depoe.** One of the forage samples taken from the property of these appellants contained 13 parts per million of fluorine. The others contained less than this. All were, therefore, within the normal range (*supra*, p. 18). The same conclusion must be drawn as to the urine samples, as the one with most fluorine contained only 3 parts per million (*supra*, p. 19).

The herd examinations by the following veterinarians on the following dates disclosed no fluorosis:

<i>Veterinarian</i>	<i>Date</i>
Garlick	5-25-50 (R-VII-1874)
Garlick	7-13-51 (R-VII-1897-1898)
Phelps	7-13-51 (R-VIII-2284)
Phelps	10-28-53 (R-VIII-2290, 2295)
Chapman	10-28-53 (R-VIII-2107-2108)

(5) **Ford.** No reference to the operations of these appellants may be found in Appellants’ Brief (Point

II). The fluorine content of the forage samples taken on their property was within the normal range, being 15 parts per million or less. The same was true of the urine samples, and the highest fluorine content found was 4.3 parts per million (*supra*, p. 19).

No injury or damage from fluorosis was discovered by the following veterinarians during examinations of appellants' cattle on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Phelps	9-20-50 (R-VIII-2281-2282)
Phelps	7-13-51 (R-VIII-2284)
Garlick	7-13-51 (R-VII-1898-1899)
Phelps	10-26-53 (R-VIII-2287-2288)
Chapman	10-26-53 (R-VIII-2097, 2100)

Notwithstanding the above data, Mr. Ford listed a number of ailments which he claimed his cattle had suffered from since he moved on the property which he occupies as a lessee. One of these was loss of milk production. His testimony on this point was so discredited on cross-examination as to entitle the remainder of his testimony to no weight. Mr. Ford moved to the property which he now occupies in December, 1947 (R-IV-740). His milk production during 1948 was good. His production dropped substantially in 1949 and remained down during 1950 and 1951. During all four years he had approximatey 28 head in his milking

string (R-IV-741). He thought he received more income from the sale of dairy products in 1948 than in 1949 (R-IV-742). In his United States income tax returns, however, he reported the following income from such sales during these years (R-IV-743):

1948	\$11,526.90
1949	13,160.32

Mr. Ford attempted to explain the fact that his income was almost \$1,500 greater in 1949 than in 1948 on the ground that he had only 24 cows early in 1948 and had acquired 28 by the end of that year (R-IV-754). However, he listed 38 cows as the number on hand on January 1, 1949, in his personal property return (R-IV-757).

Mr. Ford further testified that his worst year was 1951, when only 15 to 16 head out of 28 were in good condition and producing normally (R-IV-746-747). He claimed there was an improvement in 1953, and classed the summer of 1953 with 1948 (R-IV-726, 748). However, he testified that only 10 head out of 28 were giving normal production (R-IV-748-749).

(6) **Hester.** These appellants left the Camas-Washougal area in the fall of 1951 when they moved to Aurora, Oregon (R-IV-337). There was no evidence introduced concerning forage and urine samples relating to their operation. Their cattle were examined on

July 13, 1951, by Drs. Phelps and Garlick. Neither found evidence of damage by fluorosis (R-VII-1899-1901; VIII-2284).

These diagnoses were confirmed to a great extent by Mr. Hester's testimony. While he listed a number of conditions which he claimed his herd suffered from before moving to Aurora, he admitted that the animals were in pretty fair flesh from 1947 to 1951, and that there was a substantial increase in production from year to year during this period (R-IV-392, 393, 414-415).

Because of the multitude of contradictions in his other testimony, the existence of the ailments claimed must be discounted. The following table sets forth some of the inconsistencies between his testimony at the trial and his deposition testimony:

Trial

Deposition

- | | |
|---|---|
| 1. Goldendale hay was purchased and fed during the winters of 1947-1948, 1948-1949, 1949-1950 and 1950-1951 (R-IV-380-382). | 1. No hay was purchased during 1947 and 1948 (R-IV-383-384). |
| 2. 6 acres of hay grown in 1951 (R-IV-385-386). | 2. 12 acres in hay (R-IV-386). |
| 3. Hay grown produced 12 tons (R-IV-386). | 3. 23-30 tons produced (R-IV-386-387). |
| 4. 12 tons of hay instead of 23 produced in 1951 because of <i>rain</i> (R-IV-387). | 4. 23 tons rather than 30 tons produced in 1951 because of <i>dry</i> weather (R-IV-387). |
| 5. Hay produced was sold (R-IV-388). | 5. No hay sold (R-IV-388). |

This summary sets forth some of the inconsistent testimony of the witness. Similar inconsistencies exist between his deposition testimony read at the trial and his federal income tax returns, and between various portions of his testimony at the trial. His testimony is entirely valueless and thoroughly discredited.

(7) **Isbister.** No forage samples were taken from the property owned by these appellants. However, the fluorine content of the urine samples taken was normal, the highest being only 2.4 parts per million (*supra*, p. 19).

No evidence of damage or injury from fluorosis was found by the veterinarians examining the Isbister herd on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Garlick	7-12-51 (R.VII-1888, 1891-1892)
Phelps	7-12-51 (R-VIII-2282-2283)
Phelps	8-25-53 (R-VIII-2285-2286)
Chapman	8-25-53 (R-VIII-2088-2089)

As a matter of fact, Dr. Guard, appellants' veterinarian classified the general condition of the herd as "good" (R-VII-1779).

Mr. Isbister referred to a number of conditions affecting his herd which he attributed to the operation of appellee's Troutdale plant. However, an analysis of his testimony shows there was little of substance to the

same. At the time his deposition was taken in 1951 he testified that his cattle were "all fat and in good condition" (R-IV-508). At the trial he testified that his animals "stay in fairly good condition" (R-IV-479). Rex Ross, appellants' witness, testified that when he visited the farm in 1951 and 1953 the herd was "in very good condition" (R-V-789). The herd's milk production was normal during 1950 and 1951. The production for 1952 and 1953 was the same as 1950 and 1951 (R-IV-493).

At the same time he referred to six head which he sold because of lameness or poor production. The following table lists some of these animals and comments concerning the alleged reasons for sale:

<i>Cow</i>	<i>Reason</i>
Daisy	Old age (R-IV-483).
Pansy	Not lame, nor stiff. Always a poor producer. In his deposition he testified she was in "pretty good condition" and had normal production (R-IV-494-495).
Poll	Bag trouble (R-IV-496-497).
Flo	Bag trouble. Possible mastitis (R-IV-497-498).

There were nine animals in the Isbister milking string at the time of trial (R-IV-473). His comments as to seven of these indicate the herd was in good condition and normal:

<i>Cow</i>	<i>Remarks</i>
Lena	Good condition with fair production. Good production in 1951 and 1952. (R-IV-499-500).
Dolly	Good production all the time. No stiffness or rough hair (R-IV-500-501).
Jean	Production "about normal" since 1948 (R-IV-501-502).
Jo Ann	Good condition. Good production. (R-IV-503).
Lilly	Good condition and good production since first freshening (R-IV-504).
Dot	Good condition (R-IV-504).
Joy	Normal (R-IV-505).

(8) **Norelius.** No reference to these appellants is made in Appellants' Brief (Point II). The highest amount of fluorine found in forage samples on their property was 12 parts per million. The amount of fluorine in urine was 2.3 parts per million or less. These results were within the normal range (*supra*, p. 18).

The herd of these appellants was examined by the following veterinarians on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Garlick	7-12-51 (R-VII-1892, 1895)
Phelps	7-12-51 (R-VIII-2283)
Phelps	10-26-53 (R-VIII-2288)
Chapman	10-26-53 (R-VIII-2101 2104-2105)

No evidence of injury or damage from fluorosis was discovered.

Mr. Norelius testified that his cattle had suffered from a condition which he apparently attributed to the operation of the Troutdale plant, and that some of them had died (R-V-1119). However, he also stated that his herd had improved by 1951 and was presently "awfully close" to normal (R-V-1127, 1129). When questioned about the deaths of some of his cattle, he could not remember how many died and in what years. It is also significant that the specific deaths which he could recall were attributable to causes other than the operation of the plant (R-V-1132-1133).

(9) **Robson.** There is also no reference to these appellants in Appellants' Brief (Point II). The most fluorine found in any of the forage samples taken on the properties of these appellants was 12 parts per million. The most fluorine found in the urine samples was 2.7 parts per million. These results, of course, were normal (*supra*, p. 18).

No evidence of injury from fluorosis was found by the following veterinarians who examined the herd on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Phelps	9-20-50 (R-VIII-2281-2282)
Phelps	7-13-51 (R-VIII-2284)
Garlick	7-13-51 (R-VII-1901, 1903-1904)
Phelps	10-28-53 (R-VIII-2292, 2295)
Chapman	10-28-53 (R-VIII-2109-2110)

Mr. Robson also listed a number of conditions which he claimed were abnormal and which he attributed to the operation of the Troutdale plant. One of these was a decrease in milk production, from which all the appellants contend they suffered (R-V-897). If there is as little of substance to the other conditions as there is to the claimed loss of milk production, his testimony as to the other conditions should be disregarded entirely. The following table sets forth the Robson income from the sale of dairy products during the following calendar years and the number of milk cows during the same periods:

1949	28 (R-V-883,899)	\$6,568.37 (R-V-907)
1950	28 (R-V-883, 899)	9,720.58 (R-V-907)
1951	26-28 (R-V-900)	7,932.25 (R-V-907)
1952	32 (R-V-899)	10,000.+ (R-V-907)

The foregoing table shows that instead of suffering a loss of production these appellants enjoyed roughly a 50 per cent increase in income from the sale of milk during the years in question.

(10) **Seekins.** The forage sample on this property contained 19 parts per million, which is not abnormal. The most fluorine found in the urine samples was 5.9 parts per million. This, too, is within the normal range (supra, p. 18).

Examinations by the following veterinarians on the following dates failed to disclose injury or damage from fluorosis:

<i>Veterinarian</i>	<i>Date</i>
Garlick	7-12-51 (R-VII-1875, 1878)
Phelps	7-12-51 (R-VIII-2282-2283)
Phelps	10-28-53 (R-VIII-2294-2295)
Chapman	10-28-53 (R-VIII-2109-2110)

One of appellants' veterinarians testified that only two animals had a dental condition which he would attribute to fluorosis (R-VII-1783).

Mr. Seekins had the occasion to call a veterinarian to his farm on several occasions from 1947 to the time of trial. In no instance was the visit necessitated by conditions attributable to fluorosis (R-IV-545-549).

Mr. Seekins was asked whether his herd had not produced between 300 and 325 pounds of butterfat per cow during the five years preceding the trial. At the time his deposition was taken on August 30, 1951, he had testified that production was 310 to 320 pounds per cow (R-IV-551-554). This is exactly the production Mr. Ross, appellants' witness, indicated that the herd would give under ordinary circumstances (R-V-798).

(11) **Stauffer.** The urine and forage samples from this farm did not contain more than the normal amount of fluorine. The most fluorine found was 15 parts per

million in forage and 2.3 parts per million in urine (supra, pp. 17, 19).

No clinical evidence of fluorosis was found by the following veterinarians who examined the herd on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Garlick	7-13-51 (R-VII-1905, 1907)
Phelps	7-13-51 (R-VIII-2284)
Phelps	11-12-53 (R-VIII-2296-2297)
Chapman	11-12-53 (R-VIII-2109-2110)

The only veterinarian whose testimony was in conflict with the diagnoses of Drs. Chapman, Phelps and Garlick is Dr. Keller, appellants' witness.

Mr. Stauffer testified that he had had to sell cows since 1948 because of drop in production and lameness, which he attributed to the operation of the Troutdale plant (R-IV-627). He testified at the time his deposition was taken that in a herd of 25 cows 7 to 8 would be disposed of each year under normal circumstances (R-IV-641). This would be 28 to 32 per cent. The following table, which sets forth actual culling by these appellants and the number of animals which they would expect to dispose of under ordinary circumstances, indicates that their culling was not unusual:

<i>Year</i>	<i>Number in Herd</i>	<i>Number Sold</i>	<i>Normal Sales (30%)</i>
1949	25 (R-IV-660)	5 (R-IV-644)	7.5
1950	26 (R-IV-660)	10 (R-IV-644)	7.8
1951	26 (R-IV-660)	11 (R-IV-644, 658)	7.8
1952	28 (R-IV-660)	1 (R-IV-644)	8.4
1953	33 (R-IV-660)	5 (R-IV-642)	9.9
	Total	<u>32</u>	<u>41.4</u>

(12) **Johnston.** No reference to these appellants is made in Appellants' Brief (Point II). The fluorine content of the forage and urine samples from the farm of these appellants was normal, the highest being 11 and 2.1 parts per million, respectively (*supra*, pp. 17, 19).

No evidence of injury to cattle from fluorosis was found by the following veterinarians who examined on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Garlick	9-14-51 (R-VII-1908-1909)
Phelps	9-14-51 (R-VIII-2284)
Phelps	10-28-53 (R-VIII-2291, 2295)
Chapman	10-28-53 (R-VIII-2109-2110)

Dr. Guard, a veterinarian called by appellants, would not make a diagnosis of fluorosis in this herd. He testified (R-VII-1783):

“Q. In your opinion, Dr. Guard, did the Johnston herd have fluorosis as of the time you were there?

“A. This is one of the herds that I wouldn't want to make a statement unless I had actually worked with the herd for a number of years.”

The testimony of Homer V. Johnston as to the ailments affecting his cattle which he attributed to the operation of the Troutdale plant should be disregarded entirely because of the glaring discrepancies between this testimony and his deposition testimony. For example, he testified at the trial that certain of the conditions complained of became manifest sometime near 1946 and 1947, and that during the years 1948 to 1950 inclusive, the herd was not enjoying a normal condition and was not producing the normal amount of milk (F V-976-980). This testimony is in direct conflict with Mr Johnston's deposition testimony on the same subject (F V-981-982):

"Q. Well, referring to your deposition which was taken on or about September 18, 1951, and referring particularly to pages 60 and 61, do you recall testifying as follows:

'Q. Would you say that up to the year 1950 your milk production was generally normal and the condition of your cattle was generally normal?

'A. Yes, I do.

'Q. So that the first signs of any illness or adverse effect upon your herd which you attribute to the aluminum plant occurred during the year 1950, is that correct?

'A. Well, let's see. This is 1951, is it not?

'Q. Yes.

'A. Yes, prior to the beginning of 1950 I didn't see anything.

'Q. You didn't see anything?

'A. Abnormal or out of the way. * * *

'Q. During the period prior to 1950 was the hair of the herd in general what you would call normal?

'A. I think so, nothing serious otherwise.

'Q. Would you say that the milk production of the herd in general was normal?

'A. Yes.

'Q. Did you observe any unusual amount of lameness and stiffness?

'A. Not prior to 1950.' "

(13) **Raymond A. Arvidson.** The claims of these appellants are also not discussed in Appellants' Brief (Point II). No forage samples were taken from their property. The most fluorine found in the urine samples taken from animals in the herd was 8.3 parts per million in one sample, which is not above normal (*supra*, p. 18).

Examinations of the herd of these appellants by the following veterinarians failed to disclose injury or damage from fluorosis:

<i>Veterinarian</i>	<i>Date</i>
Phelps	9-3-53 (R-VIII-2286-2287)
Chapman	9-3-53 (R-VIII-2089-2092)

Dr. Garlick did not examine this herd. Dr. Guard examined the herd for appellants and testified as follows (R-VII-1783-1784):

“A. As far as the incisor teeth, another one of these herds that I do not know the history on and I call all the teeth normal. Except number 11 shows a little wear on one of the incisors. Again, I didn’t mark condition on this herd as it wasn’t anything outstanding as far as the condition goes.

“Q. Have you an opinion as to whether or not this herd was suffering from fluorosis as of the time you saw it?

“A. I don’t know.”

f. Whiteaker action.

The following review of the proof relating to the Whiteaker appellants applying the standards previously referred to indicates that their claims of damage to cattle are also without merit.

(1) **Whiteaker.** Appellee did not maintain a regular forage sampling station on the property of these appellants. The following table summarizes the amount of fluorine in parts per million found in forage taken by appellee at the two stations nearest their property (R-I-156-161):

<i>Year</i>		<i>Maximum</i>	<i>Minimum</i>	<i>Average</i>
1950	—No. 7	19	3.0	11
	—No. 5A	39	3.8	16
1951	—No. 7	26	4.3	11
	—No. 5A	15	0.7	8.4
1952	—No. 7	60	5.3	26
	—No. 5A	53	4.0	19
1953(9-30)	—No. 7	42	5.0	17
	—No. 5A	22	7.5	13

All the samples contained less than 75 parts per million of fluorine, the maximum amount being administered by Dr. Schmidt to his experimental herd without effect on size or milk production (*supra*, p. 34). With a few exceptions all contained less than 50 parts per million of fluorine, the maximum amount being fed by Dr. Phillips without deleterious effects (*supra*, p. 33).

Personnel from the Western Washington Experiment Station did take forage samples on the property of these appellants during this period. The following table setting forth the fluorine content of said samples in parts per million shows that there was even less fluorine on the property than at the two areas referred to above where appellee had been sampling (R-I-162-164):

<i>Year</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Average</i>
1950	12	0	4.1
1951	23	3	11
1952	31	5	12
1953	41	5	14

The urine samples taken from animals in the herd of these appellants are another indication that no injury occurred. The following table sets forth the *maximum* amounts of fluorine found in samples taken on the following dates:

<i>Date</i>	<i>Fluorine</i>
10-13-52	13.3 (R-I-165)
10-20-52	19.3 (R-I-165)
6- 4-53	6.8 (R-I-166)
8- 4-53	2.9 (R-I-166-167)

The samples taken in 1953 contained a normal amount of fluorine (*supra*, p. 18). Some of those taken in 1952 contained more than the normal amount. However, the amount in each instance was not sufficiently high to indicate that the animal in question was injured or damaged by fluorosis. Dr. Phillips' uncontradicted testimony was that the amount of fluorine in each instance was below the damaging level (R-VIII-2016-2018). The sample with the most fluorine (19.3 parts per million) contained far less fluorine than the highest sample obtained by Dr. Schmidt from his experimental herd (49 parts per million) where cattle were consuming up to 75 parts per million of fluorine without damage.

Animals in the appellants' herd were examined on the following dates by the following veterinarians:

<i>Veterinarian</i>	<i>Date</i>
Phelps	11-21-50 (R-VIII-2298, 2303-2304)
Phelps	10-20-52 (R-VIII-2300, 2303-2304)
Chapman	10-20-52 (R-VIII-2113, 2117-2118)
Garlick	12-19-52 (R-VIII-1922, 1925-1926)
Phelps	6- 4-53 (R-VIII-2300, 2303-2304)
Phelps	8- 4-53 (R-VIII-2301, 2303-2304)
Chapman	8- 4-53 (R-VIII-2113, 2117-2118)

None of these veterinarians found a condition present in the animals examined on the above dates which they attributed to injury from fluorosis. The teeth of a few animals showed cosmetic changes attributable to the ingestion of more than normal amounts of fluorine, but ingestion causing the changes occurred prior to the period for which damages may be recovered herein (R-VIII-2303-2304; R-VII-1926).

(2) **Rawnsley.** Appellee commenced taking forage samples on the property of these appellants in 1952. The following table summarizes the amounts of fluorine in parts per million from these samples (R-I-175):

<i>Year</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Average</i>
1952	21	11	16
1953 (9-30)	22	3	15

Similar samples were taken by Western Washington Experiment Station personnel. The results are summarized in the following table (R-I-176-178):

<i>Year</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Average</i>
1950	16	4	9.5
1951	35.5	2	15.8
1952	66	2	19
1953 (10-12)	25	4	11

Other samples taken by the same organization in 1952 contained more than the normal amount of fluorine, the highest being 65.8 parts per million (R-I-180).

None of the above samples exceeded the 75 parts per million being fed by Dr. Schmidt. Only 4 out of 62 samples contained more fluorine than the 50 parts per million being fed by Dr. Phillips. The most fluorine in the forage was during 1952 according to the above data. The data for this year were called to Dr. Phillips' attention, and he testified (R-VIII-2075-2076):

"Q. Well, I will give you the question. Assume that the animals in your herd are receiving twenty parts per million were to be shifted over to the values shown on page 22 of the Whiteaker pretrial order for the year 1952, running from February through December, that is the values of forage, would you expect the animals' experience to be any different from that which you observed in your group of four animals receiving twenty parts per million of fluorine in the form of sodium fluoride?

"A. I believe their performance would be very similar because only for a short period of time have they been subjected to sixty-six and sixty-three parts per million and much of that interval during the course of the year in 1952 is far below the amount which would be equivalent to twenty parts per million in our experimental setup.

"In other words, out of a third of the year it is [not] below ten parts per million and that might be very normal for many cattle feeds in many sections of the country."

None of the urine samples taken from animals in the herd contained more than the normal amount of fluorine as shown by the following table setting forth the dates upon which samples were taken and the maximum amount of fluorine found in each sample on each date:

<i>Date</i>	<i>Sample</i>
10-12-52	8.9 (R-I-179)
10-17-52	10.4 (R-I-179)
6-25-53	3.2 (R-I-180)
10-19-53	6.0 (R-VII-1650)

The conclusions drawn from the foregoing data are confirmed by examinations of the cattle of these appellants by the following veterinarians on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Phelps	2-13-52 (R-VIII-2304)
Garlick	12-19-52 (Ex. 1566) (R-VIII-1929-1930)
Phelps	10-19-53 (R-IX-2313)
Chapman	10-19-53 (R-VIII-2113, 2115-2117)

All these veterinarians testified that the animals examined by them had not been damaged by fluorosis since November 12, 1950 (R-IX-2311-2314, 2319; R-VIII-2115-2117; R-VIII-1929-1934).

One of Mr. Rawnsley's complaints was a type of scours which he attributed to the operation of the Longview plant. He mentioned in particular a siege of scours which occurred about June 15, 1953, became severe by June 20, 1953, and lessened thereafter. This occurred with the onset of westerly winds (R-VI-1205-1206). On cross-examination, he admitted that the fluorine content of forage samples taken on May 25, 1953, and June 22, 1953, was 4 and 9 parts per million, respectively (R-VI-1226). This is normal by the testimony of any of the witnesses expressing opinions on the subject. Any scours which the Rawnsley herd experienced during this period could not have been caused by the operation of the Longview plant.

The production record of the Rawnsley herd is such that it cannot be reconciled with a claim that operation of the plant injured the animals. In 1949, the herd enjoyed the highest production in the county for Dairy Herd Improvement Association herds over 40 cows (R-VI-1236, 1241). Part of the herd was pictured on the cover of the 1950 annual report of the Cowlitz County Dairy Herd Improvement Association (R-VI-1242-1243). 15 cows out of the herd were listed on the honor roll of the Dairy Herd Improvement Association high producers for the year 1950. 10 were similarly cited for the year 1951, 9 for the year 1952, and 13 for the year 1953 (R-VI-1250-1252).

(3) **Goldsmith.** No reference is made to these appellants in Appellants' Brief (Point II). Neither appellee nor Western Washington Experiment Station engaged in periodic forage sampling on the property of these appellants which is south of the Rawnsley property but more distant from the Longview plant (R-I-184). The only forage samples introduced in evidence contained 9.4 and 8.9 parts per million of fluorine, which was below the damage level. Samples of home grown hay, barley and mixed grain contained 2.9, 1.4 and 1.5 parts per million, respectively (Ex. 1624).

The greatest amount of fluorine found in the urine samples introduced in evidence was 5.1 parts per million, which of course was normal (*supra*, p. 18).

The following veterinarians examined the Goldsmith herd on the following dates:

<i>Veterinarian</i>	<i>Date</i>
Chapman	10-20-52 (R-VIII-2113-2115)
Garlick	12-19-52 (R-VIII-1934, 1936)
Phelps	10-19-53 (R-IX-2318-2319)
Chapman	10-19-53 (R-VIII-2114-2115)

None of these veterinarians concluded that the cattle examined by them on the above dates had been damaged by fluorosis during the period for which damages are sought (R-IX-2318-2319; R-VIII-2112, 2115; R-VIII-1934, 1936).

These opinions are borne out by the milk production of this herd. The average amount of butterfat produced per cow was as follows (R-VI-1349-1350):

<i>Period</i>	<i>Butterfat (pounds)</i>
1948-1949	272.3
1949-1950	293.1
1950-1951	314.7
1951-1952	315.6
1952-1953	259.3

Thus, the production of this herd has increased each year during the last five years except for the last year.

As a matter of fact, Mr. Goldsmith's willingness to purchase cattle owned by persons living in the vicinity of the plant indicates no real concern about the effect of the plant upon livestock. He purchased the original herd from his brother, who had leased the farm before him (R-VI-1336-1337). 16 head were purchased from Don Wayrynen, who lived $3\frac{1}{2}$ miles from the plant (R-VI-1338, 1362). 2 head were purchased from V. D. Walker, whose farm was across the Columbia River from the plant (R-VI-1338, 1362). As late as 1952 he purchased a heifer from Cecil Burns, who lived 1 mile from the plant (R-VI-1365, 1367).

(4). **Josephson.** There is no reference to these appellants in Appellants' Brief (Point II). As previously noted, no forage samples were taken on this farm (*supra*,

p. 22). The highest fluorine content of the urine samples was 5.3 parts per million, which of course is normal (supra, p. 18).

The cattle owned by these appellants were examined on the following dates by the following veterinarians:

<i>Veterinarian</i>	<i>Date</i>
Garlick	12-19-52 (Ex. 1567) (R-VIII-1926-1927)
Phelps	8- 4-53 (R-IX-2316, 2319)
Chapman	8- 4-53 (R-VIII-2113, 2117)

None of these veterinarians concluded that the cattle examined had been damaged or injured by fluorosis (R-VIII-1926-1929; R-IX-2317, 2319; R-VIII-2113, 2117).

Mr. Josephson is another of the appellants who attributes the sundry ills and ailments of his cattle to the operation of the Longview plant, but who has been willing to purchase cattle from persons operating nearer to the plant than he. In 1948 and 1949, for example, he purchased 6 Jersey cows from Claude Anderson, who lives 1 mile from the plant (R-VI-1372, 1421).

With these animals as a foundation he built up a herd which became the highest producing Dairy Herd Improvement Association herd in Cowlitz County in its group for a 3 year period ending on January 31, 1952 (R-VI-1422-1423). Most of the animals in the herd were listed on the honor roll of high producers during this

period. The following table shows the number of animals in the herd for the following years and the number so cited (R-VI-1427, 1431-1432, 1460):

<i>Year</i>	<i>Number in Herd</i>	<i>Number on Honor Roll</i>
1950	7.6	6
1951	9.54	6
1952	14.06	5
1953	10-13	7

It is impossible to reconcile these milk production records with the claims of animals injured and damaged because of the operation of the Longview plant.

2. Appellants failed to sustain the burden of proving that the proximate cause of any injuries to their cattle was appellee's operation of the plants.

In order to prove that appellee's operation of the Troutdale and Longview plants caused harm to appellants' cattle, appellants must prove not only that the cattle were injured but also that the injury in each case was caused by appellee's operation of the plants.

It has already been demonstrated that appellants' cattle could not have been injured because of appellee's operation of the plants during the period for which damages are claimed (*supra*, II-A-1). A review of the proof also shows that the assertedly poor condition of appellants' cattle during this period was attributable

to causes other than consumption of forage containing a fluorine content above normal during the period for which damages may be claimed. If these conditions did exist as claimed by appellants, they are attributable entirely to ingestion occurring prior to the period for which damages may be claimed. Dr. Keller admitted that the condition of the teeth in some of the animals was caused by ingestion during such earlier years (R-III-322, 326).

a. Arvidson action.

No fume collection system was in operation at the Troutdale plant from 1942 to 1945 (3½ years). Since appellee's operation of the plant, a fume collection system has always been operating (*supra*, p. 2). Thus, if cattle were injured by the operation of this plant, one would conclude that the injury would be most severe and most apparent during the 3½ year period of operation without a fume collection system. This conclusion, which is inescapable, cannot be reconciled with the testimony of appellant after appellant in this case who testified that the conditions complained of were not observed until *years* after the plant had been in operation. The only inference to be drawn from this fact is that the testimony of such witnesses on this point was false, or that if the conditions existed they were attributable to some cause other than the

operation of the plant, such as disease. The record contains evidence to support both inferences as shown by the following review of the proof:

(1) **Albert A. Arvidson.** These appellants commenced their operation of the farm in 1941 (R-I-26). The cattle were in normal physical condition and gave normal production from 1941 to 1946. They first observed unusual conditions in 1946 (R-V-1068-1069). The plant was not operating from September 7, 1945, to September 23, 1946 (R-I-20). These conditions were first observed when the plant was not even operating

The herd has a history of Bang's disease (R-V-1074-1075). Difficulties have also been encountered with milk fever (R-V-1073-1074).

(2) **Baker.** There have not only been reactors to Bang's disease in this herd, but also on one occasion the entire herd has been quarantined (R-IV-687).

One animal reacted positively during tuberculosis tests (R-IV-697).

(3) **Brandt.** These appellants purchased part of their property in 1940 and the remainder in 1944 (R-I-31). None of the conditions complained of was observed from 1942 to 1946 (R-V-918-919). The milk production was normal (R-V-939). The first indication that pro

duction and condition were not normal occurred in 1948 (R-V-940).

Appellants sold a number of animals in 1948 and 1949. Mr. Brandt testified at his deposition that the 1949 sales were due to a shortage of feed (R-V-944-946).

There has been some mastitis in the herd (R-V-942). The only cow that died was examined by Dr. Keller, who did not state the cause of the animal's death (R-V-947).

If the herd was receiving an excessive amount of fluorine, the source was in their feed. Samples of mineral tonic taken from the farm on October 28, 1953, contained 135 parts per million of fluorine (R-VII-1645-1646). The fluorine content of the pasture in the area did not begin to approach this amount during the years in question.

(4) **Depoe.** This herd has a history of suffering from osteomalacia, mastitis, Bang's disease and tuberculosis (R-VII-1866-1867; R-IV-593, 602-603).

Mr. Depoe claimed that he was forced to sell a number of animals because of fluorosis. The record indicates that many of these animals were sold for other reasons:

<i>Animal</i>	<i>Reason for Sale</i>
Bonnie	Mastitis (R-IV-593)
Tillie	10 years old (R-IV-593)
Peggy	Mastitis (R-IV-594)
Babe	11-12 years old (R-IV-596)
Boss	10 years old (R-IV-596)
Bab	Udder trouble (R-IV-600)
Betty	Udder trouble (R-IV-601)
Queen	Udder trouble (R-IV-602)

Mr. Depoe also was apparently feeding his animals far more fluorine than they could possibly receive from forage upon which air-borne fluorides may have been deposited. A sample of Digesta Bone, a mineral supplement, taken from his farm on October 28, 1953, contained 563 parts per million of fluorine (R-VII-1646).

(5) **Ford.** These appellants commenced leasing their property in 1947 (R-I-34). Milk production was normal until 1949 (R-V-741). The conflict and contradictions in the record as to the condition of the animals thereafter and their production makes it impossible to conclude that the condition of the herd, if actually not normal, was attributable to the operation of the Troutdale plant (*supra*, pp. 47, 48).

These appellants also apparently made it a practice to feed far more fluorine to their herd than the animals could consume by grazing on pastures subject to the deposition of air-borne fluorides. A sample of Watkin

Stock Mineral Compound taken from the farm on October 26, 1953, contained 1,340 parts per million of fluorine (R-VII-1643-1644).

(6) **Hester.** These appellants testified that they first noticed unusual conditions in their cattle in July, 1948 (R-IV-377). The animals in which they observed these conditions had been purchased by them from the previous lessee, Frank Lucie, who had grazed them on the property from 1944 to 1947. Mr. Hester did not observe any of these conditions at the time of purchase. Yet the herd had been grazing on this property not only during a portion of the time appellee was operating the plant, but also for more than a year during the period when the Aluminum Company of America was operating the plant without any collection system (R-IV-374-375).

These facts when considered with the number of times that Mr. Hester was impeached on cross-examination demonstrate that the operation of the Troutdale plant in no way caused or contributed to the woes of which he complained, whether real or imaginary (*supra*, pp. 49, 50).

(7) **Isbister.** These appellants purchased their property in 1941 (R-I-36). They have always had cows on the place (R-IV-472). Yet they first experienced low production in 1947, and did not observe stiffness in their

cattle until 1949 (R-IV-487-489). These conditions, therefore, developed only after the plant was being operated with controls.

When these facts are considered together with the detailed review of the evidence previously made showing no injury, it is apparent that the Troutdale plant was not the source of the complaints of these appellants (*supra*, pp. 50-52).

(8) **Norelius.** These appellants purchased most of their property long before the Troutdale plant was built (R-I-40-41). However, nothing abnormal about the condition of their cattle was observed by them prior to 1947. The condition and production of their cattle were normal during these years. The conditions complained of commenced in 1947, but improved in 1951 (R-V-1128). It is obvious from these facts that said conditions were not caused by the operation of the Troutdale plant.

If anything, the conditions were caused by feeding mineral supplements containing excessive amounts of fluorine. A sample of Digesta Bone taken from this farm on October 26, 1953, contained 545 parts per million of fluorine (R-VII-1644-1645).

(9) **Robson.** These appellants also assertedly suffered more from the operation of the plant with controls than without them. They acquired the property present

ly owned by them between 1919 and 1950 (R-I-41-47). A decrease in milk production did not occur until 1947 or 1948 (R-V-898).

Even though the herd was not in normal condition, it does not follow that this was attributable to the cause suggested by appellants. At least 4 head of cattle died from pneumonia during the period for which damages are claimed (R-V-895).

(10) **Seekins.** The only visits by a veterinarian for the purpose of treating the animals in this herd were in connection with (1) the failure of a cow to freshen; (2) the puncturing of a stomach vein by a fork; (3) udder trouble; and (4) indigestion (R-IV-545-547).

This herd also was exposed to a far larger amount of fluorine through faulty husbandry practices than through grazing upon pastures of the farm. A sample of Watkins Mineral Block, a mineral supplement, taken from this farm on October 28, 1953, contained 480 parts per million of fluorine (R-VII-1649).

(11) **Stauffer.** These appellants purchased their property in 1937 (R-I-48). The alleged drop in milk production did not occur until 1948 or 1949. This was followed by lameness (R-IV-638-639).

3 animals were condemned for tuberculosis (R-IV-632, 645). Mastitis has also been a problem (R-IV-647-

648). There has also been some difficulty with Bang's disease (R-IV-644-647).

(12) **Johnston.** Homer V. Johnston has lived on the property being occupied by him for over 60 years (R-V-954). He first noticed the conditions complained of in 1946 or 1947 (R-V-977).

At one time or another during the claim period animals in the herd have suffered from mastitis, acetone-mia, milk fever and bacteria dysentery (R-V-984, 987-989).

(13) **Raymond A. Arvidson.** This farm was purchased by these appellants in 1942 (R-I-52). They did not observe anything unusual about their cattle until 1948 (R-V-1103).

The cattle in this herd have suffered from Bang's disease. The herd was quarantined because of this in 1951 and remained under quarantine until 1953 (R-V-1105-1107).

b. Whiteaker action.

The proof also shows that the condition of the cattle of these appellants, if not normal, was attributable to causes other than consumption of forage containing a fluorine content above normal.

(1) **Whiteaker.** As noted previously, Dr. Garlic did not discover any animals in this herd which had

been injured by fluorosis. He visited the farm on July 11, 1951. Prior to doing so, he examined the herd's Dairy Herd Improvement Association production records. From this examination and said visit, he concluded (R-VIII-1917-1922):

1. The primary problem was sterility;
2. Several animals were suffering from hoof rot;
3. Several heifers were barren;
4. One cow had a pronounced endocrine imbalance;
5. Three cows were 14 years of age or over and too old for production; and
6. Culling of marginal producers had been neglected.

Mr. Whiteaker confirmed that some of the cattle had been suffering from hoof rot. He also testified that acetoneemia and milk fever had been encountered during the period for which damages are claimed (R-VI-1507-1508).

When Dr. Phelps examined some cattle from the herd on August 4, 1953, he observed several with quarters dried up because of mastitis (R-VIII-2302).

(2) **Rawnsley.** Dr. Phelps observed a large number of blood-sucking lice on one group of calves during the course of one of his examinations (R-IX-2315-2316). The

herd has had some mastitis (R-VI-1227). Some of the conditions observed are characteristic of malnutrition (R-VI-1229).

No pot line was operating at the Longview plant from June 5, 1947, to March 11, 1948 (R-I-147-148). The milk production of the Rawnsley herd during a portion of this period (from December 1, 1947, to November 30, 1948) averaged 364.7 pounds of butterfat per cow. The first year that records were being kept of production of this herd and during which the plant was in operation all the time ran from December 1, 1948, to November 30, 1949. The herd reached its highest production during this test year (Appellants' Brief p. 58). This production was the highest in Cowlitz County for a Dairy Herd Improvement Association herd of over 40 cows (R-VI-1236, 1241). This production was obtained during a period when the fume collection system had not been finally installed. The last fan and wash tower were placed in operation on May 14, 1949 (R-I-151). In the years that followed, as the amount of fluorides emanating from the plant decreased, the production of this herd also decreased, instead of increased. Obviously, a causal relationship between the operation of the plant and the condition of the cattle does not exist.

(3) **Goldsmith.** This herd's production increased each year from May 1, 1948, to April 30, 1952. Pro-

duction did drop during the 1952-1953 test year (supra, p. 68).

The herd has a history of Bang's disease, mastitis, hoof rot, pleurisy and gangrene (R-VI-1344, 1346, 1364, 1366-1377).

As noted previously (supra, p. 68), Mr. Goldsmith has followed the practice of purchasing animals from farms much nearer to the Longview plant than his. If the plant caused the conditions of which he complained, these animals would have been affected prior to his purchasing them.

There is evidence in the record that the cattle in this herd were receiving fluorine from sources other than pasture grass. A sample of mineral supplement (E. M. Peet Feed Co., Oakland, California) taken from this farm on October 19, 1953, contained 30 parts per million of fluorine (Ex. 1624).

(4) **Josephson.** The herd of these appellants was the highest producing of its size on D.H.I.A. test in Cowlitz County for the 3-year period ended on January 31, 1952 (Supra, p. 69). In 1952 production fell. This drop in production coincided with an unusually high incidence of Bang's disease. This trouble commenced in January, 1950, when one animal reacted positively to the test for this disease (R-VI-1424). In May of the

same year two additional cows were condemned as reactors. These three reactors were disposed of in 1950 (R-VI-1424-1426). In May, 1952, another animal was condemned (R-VI-1426). Two animals in addition to this one were designated as reactors in September, 1952 (R-VI-1427). Four additional animals out of ten tested reacted in November, 1952. Thus, seven out of thirteen had been condemned by late 1952. These were all sold to the yards (R-VI-1427-1428).

Bang's disease lowers milk production and causes breeding difficulties (R-IX-2321-2322). These are the very matters these appellants testified that their herd suffered from (R-VI-1396, 1398).

The Josephsons also complained of an abnormal type of diarrhea (R-VI-1409). Dr. Garlick attributed the condition in one animal to a bacterial infection suggestive of Johne's disease (R-VIII-1928).

B. Even if appellee's operation of said plants was the proximate cause of injuries to appellants' cattle, the court may not award damages to appellants unless the gravity of the harm to appellants outweighs the utility of appellee's conduct.

As will be hereinafter shown (Part III, p. 89 *et seq.*), claims of damages arising out of the settling of effluents

from an industrial plant upon surrounding properties sound in nuisance. However, the "nuisance" is not actionable unless unreasonable in character and intentional.

4 American Law Institute, Restatement of the Law of Torts, (1939) Section 822, p. 226

"The actor is liable in an action for damages for a non-trespassory invasion of another's interest in the private use and enjoyment of land if,

- (a) the other has property rights and privileges in respect to the use or enjoyment interfered with; and
- (b) the invasion is substantial; and
- (c) the actor's conduct is a legal cause of the invasion; and
- (d) the invasion is either
 - (i) intentional and unreasonable; or
 - (ii) unintentional and otherwise actionable under the rules governing liability for negligent, reckless or ultrahazardous conduct."

The Washington Supreme Court has considered the matter similarly.

Riblet v. Spokane-Portland Cement Co., (1952) 41 Wash.(2d) 249, 248 P.(2d) 380, 382

Thus, even if appellee caused injury to appellants' cattle, remand for determining damages is not warranted unless appellee's conduct was both intentional and unreasonable.

There is nothing in the record to substantiate a claim that appellee in operating the two plants *intentionally* invaded the respective appellants' interests in the use and enjoyment of their properties.

Furthermore, when the utility of a person's conduct outweighs the gravity of the harm caused thereby, the invasion of an interest, even though intentional, is not so unreasonable as to constitute a nuisance.

Powell v. Superior Portland Cement, Inc., (1942) 15 Wash.(2d) 14, 129 P.(2d) 536, 538

In denying plaintiff's request that defendant be enjoined from interfering with plaintiff's use and enjoyment of his premises and for damage for injuries caused to plaintiff's property by dust from defendant's plant, the court stated:

"Appellant has practically made the community. It has invested a great deal of money in construction of its plant and has made provision for the maintenance of a necessary industry for many years to come. It has done everything that can be reasonably expected of it to reduce to a minimum the discomforts that are inseparable from such

industrial activity. To require appellant to respond in damages for its continuance, is a step toward destruction of appellant's business."

***Soukoup v. Republic Steel Corporation*, (Ohio, 1946) 66 N.E.(2d) 334, 341-342, 343**

Plaintiff brought an action at law for damages for a nuisance for injuries sustained from dust, dirt, grime, steam and vapors emitted from defendant's coke ovens and deposited upon plaintiff's property. Defendant had constructed the ovens in 1943 for the Defense Plant Corporation of America and operated them thereafter as lessee. In affirming a judgment for defendant, the court quoted with approval a comment under the Restatement of the Law of Torts, Chapter 40, Section 826, a part of which reads:

"* * * * * Regard must be had not only for the interests of the person harmed but also for the actor and for the interests of the community as a whole. Determining unreasonableness is essentially a weighing process involving a comparative evaluation of conflicting interests in various situations according to objective legal standards.' "

And the court then said:

"By far the greater weight of authority supports the law of Nuisance, as stated in the Restatement of the Law of Torts, *supra*, and the supporting authorities above referred to."

**Booth v. Rome, W. & O. T. R. Co., (1893) 140 N. Y. 267,
35 N.E. 592, 596**

Plaintiff's house was seriously injured from concussions caused by defendant's blasting of a new roadbed for its track. Plaintiff sought to recover damages from defendant for such injuries on the ground that the use of explosives by defendant constituted a private nuisance. In reversing a judgment for plaintiff, the court stated:

"It was not an act which, under all circumstances, would produce injury to his neighbor, as is shown by the fact the other buildings near by were not injured. The immediate act was confined to its own land; but the blasts, by setting the air in motion, or in some other unexplained way, caused an injury to the plaintiff's house. The lot of the defendant could not be used for its roadbed until it was excavated and graded. It was to be devoted to a common use; that is, to a business use. The blasting was necessary, was carefully done, and the injury was consequential. There was no technical trespass. Under these circumstances, we think, the plaintiff has no legal ground of complaint. The protection of property is doubtless one of the great reasons for government. But it is equal protection to all which the law seeks to secure. The rule governing the rights of adjacent landowners in the use of their property seeks an adjustment of conflicting interests through a reconciliation by compromise, each surrendering something of his absolute freedom so that both may live. To exclude the defendant from blasting to adapt its lot to the contemplated uses, at the instance of the plaintiff, would not be a compromise between conflicting rights, but an extinguishment of the right

of the one for the benefit of the other. The sacrifice, we think, the law does not exact. Public policy is sustained by the building up of towns and cities and the improvement of property."

***Rose v. Socony-Vacuum Corporation*, (1934) 54 R. I. 411,
173 Atl. 627**

Plaintiff, the owner of a large farm, sought to recover damages from defendant for a nuisance. Plaintiff alleged that defendant had polluted his waters in discharging waste products from its refinery and that a number of his hogs and hens had died as a result. In the course of its opinion the court stated on pages 631-632:

"It is an unavoidable incident of the growth of population and its segregation in restricted areas that individual rights recognized in a sparsely settled state have to be surrendered for the benefit of the community as it develops and expands. If, in the process of refining petroleum, injury is occasioned to those in the vicinity, not through negligence or lack of skill or the invasion of a recognized legal right, but by the contamination of percolating waters whose courses are not known, we think that public policy justifies a determination that such harm is *damnum absque injuria*."

***East St. Johns Shingle Co. v. City of Portland*, (1952) 195
Or. 505, 246 P.(2d) 554**

Two actions were commenced against the City of Portland for damages caused by dumping raw sewage

into a slough. In affirming judgment for defendant, the court stated on page 562:

“The law recognizes that the nuisance claims of private owners must at times yield to public interest and convenience.”

Prosser on Torts, Section 73, page 580

“The law of private nuisance is very largely a series of adjustments to limit the reciprocal rights and privileges of both. In every case the court must make a comparative evaluation of the conflicting interests according to objective legal standards, and the gravity of the harm to the plaintiff must be weighed against the utility of the defendant’s conduct.”

4 Restatement of the Law of Torts, Section 826, page 241

“An intentional invasion of another’s interest in the use and enjoyment of land is unreasonable * * * unless the utility of the actor’s conduct outweighs the gravity of the harm.”

***Amphitheaters, Inc. v. Portland Meadows*, (1948) 184 Or. 336, 361-362, 198 P.(2d) 847**

In denying plaintiff’s claim for damages for a nuisance, the court stated:

“It is not our intention to decide the case upon authority alone, divorced from reason or public policy. The photographic evidence discloses that the properties of the respective parties are not in a residential district, and in fact are outside the city limits

of Portland, and lie adjacent to a considerable amount of unimproved land. Neither party can claim any greater social utility than the other.”

C. The utility of appellee’s conduct outweighs the gravity of the harm, if any, to appellants.

The evidence shows that if appellee caused an injury to appellants’ cattle, the utility of appellee’s conduct outweighs the gravity of such injury to appellants. Reference has previously been made to the evidence on this point, together with the determination of the trial court concerning the same ,Part.I-C, p. 24 *et seq.*)

III.

The claims of appellants were subject to a two year limitation period. Even if appellants’ claims were subject to a three year limitation period, remanding of these actions to the trial court would not be warranted.

As previously indicated (*supra*, p. 6), the trial court in connection with the pre-trial proceedings in these actions determined that the two year limitation period specified in RCW 4.16.130 (R.R.S., Section 165) was applicable to the claims being asserted herein.

The subject was considered by the court again in its written decision, and the same conclusion was arrived at (R-I-97-100).

Thereafter, the court entered conclusions of law in the *Arvidson* case which provided in part (R-I-102-E, 102-F):

“II. A complaint which alleges that gases, fumes and particulates from an aluminum reduction plant settling upon properties in the vicinity of said plant have caused damage to the owners or occupants of said properties sound in trespass on the case, and not trespass, under the substantive law of the state of Washington. * * *

“IV. Defendant did not trespass upon plaintiffs properties from December 7, 1948, to November 4, 1953, because under the substantive law of the State of Washington the settling of gaseous and particulate fluorides from an aluminum reduction plant upon surrounding properties does not result in a trespass.

“V. The two year period of limitation provided for under R.C.W. 4.16.130 (Rem. Rev. Stat. 165) is applicable to plaintiffs' claims for damages to real and personal property.”

and similar conclusions of law in the *Whiteaker* case (R-I-208-C, 208-D)

A. The claims of appellants were subject to a two year limitation period.

The cases at bar were instituted in the state of Washington. Consequently, they are subject to the

applicable Washington statute of limitations. The law of the forum controls as to the limitations of actions.

53 C.J.S., Limitation of Actions, Section 27, p. 970

RCW 4.16.080 (R.R.S., Section 159) provides in part as follows:

“Within three years:

(1) An action for waste or trespass upon real property;

(2) An action for taking, detaining, or injuring personal property, including an action for the specific recovery thereof, or for any other injury to the person or rights of another not hereinafter enumerated; * * *

RCW 4.16.130 (R.R.S., Section 165) provides:

“An action for relief not herein otherwise provided for shall be commenced within two years after the cause of action accrued.”

Appellants contend that RCW 4.16.080 (1) (R.R.S., Section 159 (1)) applied to their claims for injury to real property and RCW 4.16.080 (2) (R.R.S., Section 159(2)) applied to their claims for injury to personal property.

1. RCW 4.16.130 Applied to Appellant's Claims of Damage to Real Property.

Appellants alleged in their complaints that particulates from appellee's plants were deposited upon appellants' real properties (R-I-4, 120). They contend that by reason of such allegation they pleaded a trespass as distinguished from trespass on the case (Appellants' Brief, p. 2). They further contend that they sustained the burden of proving that particulate fluorides settled upon appellants' real properties. They conclude that by having pleaded and proved a trespass they were entitled to a three year limitation period and not a two year period.

The settling of air-borne gases, fumes or particulates upon appellants' real properties could at the most have constituted only an interference with the use and enjoyment thereof and not an interference with possession. Any injuries sustained by appellants thereby could only be the consequential results of lawful acts performed by appellee upon its own property. Such an indirect invasion may under certain circumstances constitute a nuisance. It does not constitute a trespass. In order to constitute a trespass the injury must be immediate.

Joyce, Law of Nuisances (1906), p. 27

High on Injunctions (3rd ed., 1890) §739, p. 56

63 C.J. 889, Trespass, §4

The settling of gases, fumes and particulates emanating from an aluminum plant upon real property in the vicinity of said plant does not constitute trespass.

***Perrin v. Aluminum Company of America and Thayer* (W.D. Wash., S.D., 1950) Civil No. 1,352**

This case is referred to in the written decision of the trial court (R-I-98). Plaintiffs filed an action in June, 1950, in the Superior Court of the State of Washington for Clark County to recover damages for injuries to gladiolus bulb operations conducted by plaintiffs on leased property during the 1947 growing season. Plaintiffs did not characterize defendant's operation of its Vancouver aluminum plant as a nuisance and referred in their complaint to trespass statutes. After removal to the United States District Court, defendant moved to dismiss the action on the ground that the pleadings disclosed that the action was barred by the two year statute of limitations. When the matter came on for hearing before Judge Charles H. Leavy on November 20, 1950, he allowed said motion on the ground that the three year statute of limitations relating to trespass to real property and injuries to personal property was not applicable because no trespass had occurred. He stated in part:

"The Court found in the Fraser case, and I see no reason why I should reverse that position in this

case, that the activity itself was a perfectly legitimate and lawful activity, in constructing this aluminum plant to engage in reducing alumina to aluminum; the fumes carried by winds to the land of this plaintiff and others were consequential rather than purposeful and were incidental rather than intended; and that made the case, in my mind, one of trespass on the case."

The Fraser case to which Judge Leavy referred was

***Fraser v. Aluminum Company of America* (W.D. Wash., S.D., 1950) Civil No. 1,223**

in which he had stated during pre-trial conference on May 5, 1950, that the two year statute of limitations was applicable in a similar action commenced to recover damages for injuries to trees, crops, vegetation and domestic animals.

The Washington Supreme Court does not regard the settling of air-borne gases, fumes or particulates upon real property as a trespass or invasion of the same.

***Riblet v. Spokane-Portland Cement Co.* (1952) 41 Wash (2d) 249, 248 P. (2d) 380**

Plaintiffs sought to recover for damages to their residential property caused by cement dust cast there upon as a result of the operation of a cement manufacturing plant by defendant. In reversing judgment for

defendant, the court stated one of the issues to be (p. 380):

“Is the two-year statute of limitations, Rem. Rev. Stat. § 165, RCW 4.16.130, or the three-year statute of limitations, Rem. Rev. Stat. (Sup.) §§ 159 (1) and 159 (3), RCW 4.16.080 (1) and (3), applicable?”

The court held that the evidence was sufficient to support a cause of action based upon nuisance and that the plaintiffs' claims were subject to the two year statute of limitations (RCW 4.16.130) and not the three year statute of limitations (RCW 4.16.080). The court thus in effect held that activity such as that complained of sounded in nuisance, and not trespass.

Weller v. Snoqualmie Falls Lumber Co. (1930) 155 Wash. 526, 285 Pac. 446

In considering the statute of limitations applicable to an action to recover for injury from cinders, soot, ashes and charred materials carried by prevailing winds from defendant's sawmill to plaintiffs' property, the court stated on page 448:

“* * * It was the operation of the sawmills that caused the damage. The injury to the farm was in the nature of a continuing nuisance, and as stated in *Island Lime Co. v. Seattle*, 122 Wash. 632, 211 P. 285, 286: ‘We are firmly committed to the rule

that one suffering from an injury in the nature of a continuing nuisance may recover damages as often as he brings action therefor. * * * ”

***Park v. Northport Smelting & Refining Co.* (1907) 47 Wash. 597, 92 Pac. 442**

Plaintiff sought damages for the destruction of growing trees by reason of fumes and smoke from defendant's smelter. The court permitted recovery for damages accruing within two years prior to the commencement of the action, and not within the three year period which the statute of limitations provides for trespass to real property.

***Sterrett v. Northport Mining & Smelting Co.* (1902) 30 Wash. 164, 70 Pac. 266**

Plaintiff sought to recover for damages to his lands, plants and trees caused by the precipitation of fumes and smoke from defendant's smelter. The court stated on page 270:

“* * * It is lawful to operate a smelter. No one has a right, however, to pursue a lawful business, if thereby he injures his neighbor, without compensating such for the damages actually sustained. This action may be sustained also on the grounds of a continuing nuisance. *Doran v. City of Seattle*, 24 Wash. 182, 64 Pac. 230, 54 L. R. A. 532, 85 Am. St. Rep. 948.”

***Suter v. Wenatchee Water Power Co.* (1904) 35 Wash. 1,
76 Pac. 298**

This was an action to recover for damages to land caused by negligent construction and maintenance of an irrigation canal. In reversing judgment for plaintiffs on the ground that the two year statute of limitations was applicable, the court stated on page 300-301:

“* * * We must therefore conclude that, when our lawmakers provided a three-year limitation for actions for ‘trespass upon real property,’ they meant to include only such recovery as could have been had through the action of trespass at common law. It follows that actions under our present procedure, through which relief is sought for injuries to land, and which could have been had at common law through an action on the case only, are governed by our two-year statute of limitations hereinbefore cited.”

The similarity between the quoted portion of the opinion and Judge Leavy’s remarks in the *Perrin* case (supra, pp. 93, 94) is striking.

The foregoing decisions are in accord with the holding of other courts on the same point. In the following cases relief sought against the discharge of smoke, cinders and like substances was considered to be an action sounding in nuisance and not one of trespass upon adjoining property:

**Bartlett v. Grasselli Chemical Co. (1922) 92 W. Va. 445,
115 S.E. 451**

Plaintiff, a farmer, sought to recover damages from defendant, the owner and operator of a zinc reduction plant, for injuries to cattle and land resulting from fumes, gases and dust emitted from defendant's plant and borne by air currents to plaintiff's property. In reversing judgment for plaintiff, the court stated on page 455:

"The injury in respect of which this action was brought is consequential and flows from a purely private nuisance. There has been no trespass upon the plaintiff's lands. The furnaces and business working the injury are located and conducted upon the defendant's own land. * * *"

Northern Indiana Public Service Co. v. W. J. & M. S. Vesey (1936) 210 Ind. 338, 200 N. E. 620, 627 (soot and dirt from gas plant)

Columbian Carbon Co. v. Tholen (Tex., 1947) 199 S. W. (2d) 825 (carbon black and soot from carbon black plant)

Bourne v. Wilson-Case Lumber Co. (1911) 58 Or. 48, 51, 113 Pac. 52 (ashes, cinders and sawdust)

Lindley v. Hyland (1943) 173 Or. 93, 144 P. (2d) 295 (shavings and sawdust from planing mill)

The authorities which are cited in Appellants' Brief are not in conflict with the authorities to which reference has just been made. Appellants rely (p. 97) upon

certain remarks by the Honorable James Alger Fee in denying a motion to transfer the *Arvidson* action to the United States District Court for the District of Oregon (reported at 107 F. Supp. 51). Concerning this language, the trial court stated (R-I-96):

“Early in the proceedings the removal of the actions to the Oregon District Court on the ground of *forum non conveniens* was sought by defendant. The matter was extensively briefed and argued before then District Judge James Alger Fee sitting in this court by assignment. In an opinion reported at 107 Fed. Sup. 51, Judge Fee, on the allegations of the complaints and upon the oral statements of plaintiffs’ counsel during the hearing on the motion for removal, for the limited purposes of that motion accepted plaintiffs’ contention that the actions sounded in trespass. Removal was denied for several reasons but principally because under Oregon Supreme Court decisions that court has held itself without jurisdiction to deal with actions for trespass on lands outside of Oregon. There is no indication in Judge Fee’s opinion or elsewhere in the record that consideration was given to the Washington law as to whether actions of the nature of the present cases sound in trespass rather than trespass on the case. Washington law was neither directly nor indirectly considered, stated or applied in the removal decision. The parties agree that under *Erie R. C. v. Tompkins*, 305 U.S. 673, on substantive issues the cases must be decided according to Washington law.”

Appellants contend in their brief (p. 94) that Judge Fee’s remarks on trespass became the “law of the case.”

This is not so. The doctrine of the law of the case is a rule of practice and not a principle of substantive law.

***Messinger v. Anderson* (1912) 225 U. S. 436, 56 L. Ed. 1152, 1156**

“* * * In the absence of statute the phrase, ‘law of the case,’ as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided, not a limit to their power. * * *”

United States v. Fullard-Leo (C.C.A. 9th, 1946) 156 F. (2d) 756, 757; Affirmed (1946) 331 U.S. 256, 91 L. Ed. 1474

The judge before whom later proceedings are had in a case is not absolutely bound to follow the rulings of the judge before whom the earlier proceedings were had.

Appeal of Beardsley (1910) 83 Conn. 34, 75 Atl. 141, 142
21 C.J.S. Courts, Section 195c, p. 341

An interlocutory order which merely decides some point or matter essential to the progress of the case, and collateral to the issues therein, is not binding as the law of the case.

Polson Logging Co. v. United States (C.C.A. 9th 1947) 160 F. (2d) 712

The case of

Welch v. Seattle & Montana R. Co. (1909) 56 Wash.
97, 105 Pac. 166

is cited by appellants (p. 94-95) as demonstrating that "damages are presumed from the breaking of the close." This may be true. However, appellants have failed to demonstrate that in these actions the close has been broken as a matter of law. In fact, the authorities previously cited show that the contrary is true (*supra*, p. 93 *et seq.*)

The next case cited by appellants (p. 95-96),

Gray v. Harris & Son (1939) 200 Wash. 181, 93
P. (2d) 385,

is in support of the proposition that, "if defendant breaks the close, liability is absolute." However, as a matter of law the close is not broken by the settling of particulates from an aluminum plant upon real properties.

The case of

Clark Lloyd Lumber Co. v. Puget Sound & C. Ry. Co. (1916)
92 Wash. 601, 159 Pac. 774

is cited (p. 97) as indicating that "the deposit of solids presently invades a property right whenever the

damage was done, and irrespective of the amount of damage." There, the court held that defendant's blasting of stumps to which plaintiff's boom was anchored and the casting of waste, rock and dirt into a cove constituted a trespass subject to the three year period of limitations. After noting the difference between a lawful act resulting in a consequential injury and an unlawful act resulting in an immediate injury, the court held that the activity complained of resulted in an immediate injury and was wrongful in its inception because it violated an agreement between the parties (p 776):

"The blasting of the stumps and the waste of the debris over the bank and into the cove was an immediate injury. The damages which may result do not have to be immediate to sustain an action under section 159. The statute does not concern itself with the moment of time when the damage actually accrues or the amount of the damage. They may continue and grow in volume. It concerns itself only with the character of the trespass. If a thing lawful to be done results in damage, the case falls under the two-year statute. If the thing done is wrongful in its inception to the extent that it presently invades a property right, the three-year statute applies. * * *

"In the instant case, appellant did not have a lawful right to construct as it chose.' Its rights are defined in the contract which clearly implies the preservation of respondent's property for the use intended, as well as its own right to build its railroad. In the Suter Case, no damage would have resulted from the primary act of building the canal

The damage complained of was the result of its after negligence in filling the canal beyond its capacity. But here the damage, if any, came from a physical act touching the property of respondent, and theoretically, at least, was a damage in its inception."

Here, appellee has been engaged in the legitimate activity of reducing aluminum. The alleged deleterious effects of this activity are consequential and not immediate. Appellants rely (p. 97) upon the rule set forth in

**I American Law Institute, Restatement of the Law of Torts
(1934) Section 158**

The illustrations to said rule indicate that the rule was not intended to apply to an indirect invasion resulting as a consequence of lawful acts such as the deposit of effluents upon property in the vicinity of an industrial plant.

Appellants also cite (p. 98) the case of

Ure v. United States (D. Or., 1950) 93 F. Supp. 779

This case involved flooding caused by the breaking of an irrigation canal. Furthermore, the decision indicated (p. 790) that the court was applying the law of the State of Oregon, and not the law of the State of Washington, which has previously been set forth.

The cases of

***Kerr et al v. Reynolds Metals Co.* (D. Or., 1950) Civil No. 4,123, and *McCallister et al v. Reynolds Metals Co.* (D. Or., 1950) Civil No. 4,418**

which appellants also rely upon (p. 99), are likewise of no assistance. In the remarks which he made in denying defendant's motion for an involuntary nonsuit, Judge Fee made no effort to distinguish between the law of trespass as determined by the courts of the State of Oregon and as determined by the courts of the State of Washington. Thereafter, Judge Fee stated in a written opinion dated December 11, 1950 (p. 5), that, *if* he accepted appellants' theory that the actions were at law for trespass, he could not award damages to the Washington appellants because of lack of jurisdiction. He, therefore, did not expressly determine what the Washington law on this point was.

The citations (p. 99) to

87 C.J.S., Trespass, Section 13, and
52 Am. Jur., Trespass, p. 844

are likewise of no value. There is no indication that the rules stated therein are to be applied to the settling upon real properties of minute materials emanating from an industrial plant being lawfully operated.

2. RCW 4.16.130 Applied to Appellants' Claims of Damage to Personality.

Appellants also contend in their brief (pp. 100-104) that the claims for damages arising from asserted injury to their personal property are subject to a three year period of limitations. However, claims for injuries to personal properties are subject to the same limitation period as that applicable to claims for injuries to real properties. The *Perrin* case, previously referred to (p. 93) is directly in point. There, plaintiffs filed an action in June, 1950, to recover damage for injuries to gladiolus bulb operations conducted by plaintiffs on leased property during the 1947 growing season. Crops growing upon leased lands are personal property.

Brown v. Jones (1929) 130 Or. 424, 433, 278 Pac. 981
8 R.C.L. 357

The court upon motion dismissed the action as barred by the two year Washington statute of limitations.

In

***Northern Grain & Warehouse Co. v. Holst* (1917) 95 Wash. 312, 163 Pac. 775**

the court held that the two year statute of limitations applied in an action to recover damages suffered by plaintiff because defendants failed to obtain a bond

from a defaulting warehouseman. RRS § 159 (2) (RCW 4.16.080 (2)) provides as follows:

“Within three years: * * *

“An action for taking, detaining, or injuring personal property, including an action for the specific recovery thereof, or for any other injury to the person or rights of another not hereinafter enumerated;”

In response to plaintiff's contention that R.R.S. § 159 (2) applied and not RRS § 165 (RCW 4.16.130) the court stated, on pages 776 and 777:

“If full effect be given to appellant's argument, section 165 has no force or application in the law of this state and is a useless and nugatory enactment, for it is contended that the language of subdivision 2 of section 159 embraces all causes of action in which it is sought to recover for any injury ‘to the person or rights’ of the plaintiff. No cause of action arises in law until the plaintiff's person or property rights have been invaded. It is manifest that this subdivision, if given appellant's construction, would apply to all causes of action irrespective of their nature, and would embrace those causes of action provided for in other subdivisions of section 159 as well as those provided for in section 165 and other limitation statutes. That this was not the intention is manifest. Each subdivision of section 159 was intended to apply to particular forms of action which it was therein sought to enumerate, and section 165 was intended as a blanket provision to cover all other causes of action not specifically enumerated in prior sections. *This being so, we must read subdivision 2 as applying only to certain direct invasion*

of personal or property rights not otherwise 'hereinafter enumerated,' and as not including those numerous causes of action recognized by the law, among which must be included the one here pleaded if existing at all where the law imposes a liability because of indirection or default. The cause of action here pleaded is indirectly based upon the failure of public officials to perform duties imposed by law. It is not based upon any direct act of these officials injuring appellant's personal property or property rights." (Emphasis added.)

The distinction noted by the court between direct and immediate and indirect and consequential with respect to the applicability of sections 159(2) (RCW 4.16.080 (2)) and 165 (RCW 4.16.130) is the same distinction noted by this court in the *Perrin* and *Fraser* cases and by the Washington Supreme Court in *Clark Lloyd Lumber Co. v. Puget Sound & C. Ry. Co.*, *supra*, p. 107.

Neither is

***Luellen v. City of Aberdeen* (1944) 20 Wash. (2d) 594, 148 P. (2d) 849**

of assistance to appellants. In that case plaintiff sought an adjudication that his removal as police captain was illegal. The court held (p. 855) that the action was subject to the three-year period of limitations set forth in RCW 4.16.080(2) (R.R.S., § 159 (2)) because of a *direct* invasion of an *intangible* property right. There is no

similarity between the facts in that case and those in the case at bar. Furthermore, the personal property allegedly injured here is *tangible*, and not intangible.

In

***Irwin v. J. K. Lumber Co.* (1922) 119 Wash. 158, 205 Pac. 424**

plaintiff sought to recover for damages suffered when defendants constructed a trestle and booming ground in the Columbia river destroying the value of the same for plaintiff's licensed fishing operations. The court held the action to be barred by the three year statute of limitations RCW 4.16.080(2) (R.R.S., § 159(2)) whether it was (1) an action in tort to recover damages for trespass to plaintiff's *personal* property (fishing license and location); or (2) an action to recover compensation for property damaged without condemnation proceedings. This holding was proper in view of the fact that the invasion of plaintiff's property was direct in character, not consequential, and thus of the type to which the three year limitation period is applicable.

That RCW 4.16.080 (2) (R.R.S. § 159(2)) applies only to *direct* invasions of personal or property right has received additional emphasis from the Washington Supreme Court.

Noble v. Martin (1937) 191 Wash. 38, 70 P. (2d) 1064, 1068

“The suggestion that the action falls within subdivision 2 of section 159 is equally untenable. This subdivision provides as follows: ‘An action for taking, detaining, or injuring personal property, including an action for the specific recovery thereof, or for any other injury to the person or rights of another not hereinafter enumerated.’

“It was clearly and definitely held in *Northern Grain & Warehouse Company v. Holst*, 95 Wash. 312, 163 P. 775, that this statutory subdivision applies only to certain direct invasions of personal or property rights. Approval of that decision was later expressed in *Constable v. Duke*, 144 Wash. 263, 257 P. 637, and it must be regarded as stating the settled law of the state.”

B. Unless the Court finds that Appellants were Injured as a Result of the Operation of the Plants, Determination of the Applicable Limitation Period Is Moot.

The only reason for the court to consider the applicable limitation period would be in the event it decided the remand was warranted because of its decision on points I and/or II. It has already been demonstrated that remand as to these two points is not warranted. Any question as to the applicable limitation period is therefore moot.

Conclusion

Appellants failed to prove any trespass warranting remand of these actions. Appellants likewise failed to prove actionable injury to their cattle. The trial court correctly applied the two year limitations period to appellants' claims. The judgments of the trial court should be affirmed.

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United States
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for the Ninth Circuit

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vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.
W. J. WHITEAKER, et al., *Appellants*,

vs.

REYNOLDS METALS COMPANY, a corporation, *Appellee*.

*Appeals from Final Judgments of the District Court for the
Western District of Washington, Southern Division.*

HON. GEORGE H. BOLDT, Judge.

APPELLANTS' REPLY BRIEF

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HON. GEORGE H. BOLDT, Judge.

STATEMENT

The purpose of this statement is twofold. First, we wish to point out to the Court that appellee, by ignoring our argument addressed to the matter, has apparently conceded that the trial Court adopted two erroneous "factual" bases for its written decision. Second, we want to point out that appellee evidently believes that

all, we merely want to show the Court that appellee has carefully selected only those most favorable elements of the proceedings below which tend to support the findings entered. This is consistent with appellee's idea of the scope of review, but it eliminates all of the evidence which might tend to show that a mistake was made below.

REPLY TO APPELLEE'S POINT I

Appellee's first point is that fluorides in particulate form emanating from appellee's plants did not settle upon appellants' farms, but even if they did, this Court should review the evidence, decide that appellee's operations are more important than appellants' and therefore refuse a remand to the trial Court. In support of the first part of this argument, appellee deals with the Arvidson and Whiteaker actions separately. As to the former it contends that the best evidence as to whether or not any fluorides were deposited upon appellants' properties is vegetation samples taken *on those properties*. On page 17 of its brief appellee lists 22 vegetation samples so taken. All of those samples contained less than 25 parts per million (ppm) fluorine. Because Mr. Zeh, appellee's chief chemist, testified that normal values could run as high as 20-25 ppm, appellee wants this Court to conclude that appellee deposited no fluorine on the Arvidson appellants' farms at any time. On page 19 of its brief, appellee attempts to buttress this conclusion by listing 12 urine samples, all of which are claimed to be normal.

What the urine samples have to do with the problem as to whether the fluorides deposited were in solid form

or not we do not understand. The sampling did not purport to establish that. It did not purport to establish it as to the 22 samples on page 17 either. What appellee is really saying is that since the vegetation and urine samples referred to were less than "normal", it makes no difference whether or not they were solids. With that out of the way, the real trouble with appellee's argument is that of the 22 vegetation samples on page 17, all (except the five Stauffer samples which were taken November 12, 1953) were taken in the last week of October, 1953. The lawsuit was filed December 6, 1950, and the trial started November 4, 1953. With a two-year statute of limitations having been held applicable, appellee therefore wants this Court to rule whether or not solids were deposited by its Troutdale operations solely on the basis of one week's testing. It explains (Ap. Br. 20-21) that its own hundreds of forage results taken during the entire period of the lawsuit should not be considered by this Court because, although Mr. Zeh, its chemist, said those results were comparable to results that would have been obtained on the farms if the distances between the two were reasonable, he did not go further in his testimony and state what distance was "reasonable".

There are a good many reasons why appellee's forage results obtained at places other than on appellants' farms should be considered by this Court in determining whether or not a trespass was made out. In the first place, the results were compiled in Exhibit No. 1285 which appellee prepared for trial and which was received in evidence by agreement. Secondly, the results were agreed upon in the pretrial order. Third, the stations

themselves were selected by agreement for use at the trial for the very reason that they bracketed appellants' farms (Ap. Br. 21). Finally, when Mr. Zeh was first asked whether, if the results taken on locations not on plaintiffs' farms had been obtained on the farms the results would have been comparable, the Court required the question to be answered and stated that it was a "good question" (III-64). The question was answered in the affirmative (III-66). Now appellee, having helped to select the stations on which the results are based and having used them at the trial, wants to exclude this Court's consideration of them.

After making the argument just referred to, appellee goes on at page 21 of its brief to contend that even if the testing station samples were of some significance it is impossible to determine on what farms the fluorides settled or whether they were in particulate or gaseous form. In the Whiteaker action appellee makes the same argument except that it admits that on the Rawnsley and Whiteaker farms some of the samples contained an above-normal amount of fluorine (Ap. Br. 22). Similarly to the argument advanced in the Arvidson action, appellee eliminates the possibility of any above-normal amounts of fluorine being deposited upon the Goldsmith and Josephson farms by excluding the results it obtained at a testing station about a mile from those farms and the Rawnsley farm (I-169-172).

Not only does appellee urge that only the testing results obtained on the farms are material in determining whether particulates were deposited as a result of ap-

appellee's activities, it also ignores completely the argument contained on pages 16-18 of our brief showing that solids were in fact deposited upon the farms. In that portion of our brief, we pointed out that since there was no question but that 90% of the fluorides which got out of the plants were solids, and that, accordingly, 90% of the test results (not limited to those from appellants' farms) established the deposit of solids. Appellee also ignores our review of Dr. Caldwell's testimony (Br. 17, 18) to the effect that *all* fluorides arriving at the farms were in solid form. Dr. Caldwell's testimony is the only testimony as to the form of the fluorides arriving at the farms *as distinguished from the form of fluorides getting out of the plants*. Dr. Caldwell's testimony was uncontradicted and appellee does not urge that he was impeached in any way. It just ignores his testimony.

The final portion of appellee's first point is to the effect that, even if this Court holds that trespasses were made out, remands are not warranted because upon balancing conveniences which *this Court* is asked to do, no injunctive relief would be in order anyway. An Am. Jur. reference relying on an 1889 Alabama case is cited for the proposition that injunctions against trespasses are sometimes refused. *Minto v. Salem Water L. & T. Co.* (1926), 120 Or. 202, 219, 250 Pac. 722, is also cited for the proposition that harm to the public is sufficient reason for denying injunctive relief. Ap. Br. 24.

These are questions for decision by the trial Court after this Court holds that trespasses in the actions were made out. The relative convenience to the parties and

the convenience to the public are matters which the trial Court should pass on first and not this Court. The 28 Am. Jur. reference at the top of page 24 of appellee's brief makes this very clear. Whether appellants would be greatly benefited by injunctive relief or whether appellee would be greatly inconvenienced are matters for the trial Court. So far the trial Court has merely decided that trespasses were not made out. What it would do if trespasses were made out is something it ought to be allowed to decide for itself rather than have the matter decided by this Court.

REPLY TO APPELLEE'S POINT II

In our brief, instead of analyzing all of appellants' damage claims, we picked out eight of them in the two cases for the purpose of demonstrating that the trial Court had made a mistake in finding in both cases that the cattle were not injured. Within the meaning of the *McAllister* case we sought to show that a mistake had been made. In so doing we were not trying to make representative actions out of the cases as appellee seems to contend on page 29 of its brief. We are merely trying to show that the cattle were hurt.

In trying to show that the cattle were hurt, we reviewed (Br. 29-51) in considerable detail what the eight farmers said was wrong with their cows. The farmers had lived with the cows for years and we felt that what they actually observed was of considerable significance. We then (Br. 52-57) summarized those complaints to show that the differences in the farmers' complaints were

ones of degree and not of kind. To buttress the farmers' observations we then pointed out (Br. 57-62) that the more fluorine the cattle were exposed to the less milk was produced and vice versa. We showed that the physical facts, including the documentary evidence, supported that argument without question (Br. 60-62). We then reviewed the experts for appellants and finally concluded on the damage feature of the cases that appellee's defense at the trial was based solely and exclusively on admittedly incomplete experiments of Drs. Phillips and Schmidt and three veterinarians. We pointed out that the three veterinarians had done no experimental work relating fluorine intake to butterfat loss. We pointed out also that the three veterinarians nevertheless took the position that there couldn't have been any butterfat loss because the degree of tooth damage was too slight to warrant it. We concluded that in taking this position the veterinarians were obviously relying upon the incomplete experimental work of Drs. Phillips and Schmidt (Br. 76-77).

Probably the principal point urged by us in contending that appellants' cattle really were damaged was that the physical facts, including the documentary evidence, led irresistibly to that conclusion. In other words, our principal contention in support of the lost milk point was that the more fluorine the cattle got the less milk they produced and vice versa. Two of our principal illustrations of that argument were the production performance on the Rawnsley and Whiteaker farms. Our argument with respect to those two farms was as follows:

"We pointed out in Section III(a) above that in the fiscal year 12/1/48 - 11/30/49 the Rawnsley farm, as shown by the D.H.I.A. record book, produced 430 pounds B.F. on the average. Over six months before that year began, the herd stopped eating anything that could have been contaminated (VI-1167). Not until four months after that test year began did it consume home grown feed again (VI-1169). *Prior* to that year it consumed home grown feed and produced less and *after* that year it steadily declined (Sec. III(a)). The greatest *rate* of decline after the year 12/1/48 - 11/30/49 was in the year 12/1/52 - 11/30/53, (Sec. III(a)) and in that year appellee emitted 80% more fluorides than previously because it had expanded its production (VII-1673). This production performance is based on the physical facts alone, as shown by Mr. Rawnsley's testimony as to where the cattle were and what they ate." (Br. p. 60.)

"The physical facts as to Whiteaker (Sec. (a) above) are that at Kalama, 10 miles from Reynolds, the herd average gradually increased from 345.2 butterfat for the year 5/1/45 - 4/30/46 to 357 butterfat for the year 5/1/46 - 4/1/47. The rate of increase went up at Kalama in the next year ending 4/30/48 *when the Reynolds plant was closed* and was 373.9. Then the herd moved next door to Reynolds *and the plant reopened*. There was an immediate decline of over 15% to 317. Except for the year 5/1/51 - 4/30/52, the herd production has stayed about that level. In the year just mentioned it went up from 307 to 335. It isn't hard to find the reason for that either. Mr. Whiteaker testified that starting in October, 1951, there was a substantial infusion of new blood in the herd (VI-1506, 7). When Reynolds substantially increased its production in the fall of 1952, thereby materially increasing the fluorides on the Whiteaker's grass, there was a decrease of 10% to 303 for the year 5/1/52 - 4/30/53 though only one-half of that year was affected by

the increased fluorides (August 1952 - April 1953). 303 was the lowest the herd ever produced." (Br. p. 61.)

At two places in its brief appellee attempts to answer the above argument as to Rawnsley. On page 66 it says:

"The production record of the Rawnsley herd is such that it cannot be reconciled with a claim that operation of the plant injured the animals. In 1949, the herd enjoyed the highest production in the county for Dairy Herd Improvement Association herds over 40 cows (R-VI-1236, 1241). Part of the herd was pictured on the cover of the 1950 annual report of the Cowlitz County Dairy Herd Improvement Association high producers for the year 1950. 10 were similarly cited for the year 1951, 9 for the year 1952, and 13 for the year 1953 (R-VI-1250-1252)."

On page 80 it says:

"No pot line was operating at the Longview plant from June 5, 1947, to March 11, 1948 (R-I-147-148). The milk production of the Rawnsley herd during a portion of this period (from December 1, 1947, to November 30, 1948) averaged 364.7 pounds of butterfat per cow. The first year that records were being kept of production of this herd and during which the plant was in operation all the time ran from December 1, 1948, to November 30, 1949. The herd reached its highest production during this test year (Appellants' Brief p. 58). This production was the highest in Cowlitz County for a Dairy Herd Improvement Association herd of over 40 cows (R-VI-1236, 1241). This production was obtained during a period when the fume collection system had not been finally installed. The last fan and wash tower were placed in operation on May 14, 1949 (R-I-151). In the years that followed, as the amount of fluorides emanating from the plant decreased, the production of this herd also decreased,

instead of increased. Obviously, a causal relationship between the operation of the plant and the condition of the cattle does not exist."

The above two extracts from appellee's brief, particularly the latter one, represent a rather astonishing parade of half truths. Let us review this matter once more. As appellee says, the Longview plant was closed June 5, 1947, to March 11, 1948. There are three pot lines at the plant. The first reopened March 11, 1948. The second reopened March 25, 1948. Not until June 18, 1948, was the third pot line running. On May 24, 1948, Mr. Rawnsley took his cows well out of the area because of flood conditions from the Columbia River (VI-1167). Not until April 1, 1949, did they again consume any feed which could have been contaminated by appellee's operation. Thus, except for a two-week period when one-third of the plant was operating and an eight-week period when two-thirds of the plant was operating, the herd might as well have been in the Imperial Valley for nearly two consecutive years in so far as appellee's operations or the possibility of harm therefrom was concerned. Despite these undeniable facts, appellee wants this Court to conclude from the "facts" it sets forth that when the plant was running the cattle produced more than when it was closed. It elaborates on this argument by pointing out that the control system was finally completed on May 14, 1949, and "* * * In the years that followed, as the amount of fluorides emanating from the plant decreased, the production of this herd also decreased, instead of increased * * *." We have just pointed out that when the herd obtained its highest production, that is,

in the year ending November 30, 1949, it had, except for the 10-weeks period in the spring of 1948 and the period after April 1, 1949, been off fluorine completely since June 5, 1947, a period of two and one-half years. Thereafter the production steadily declined and the greatest *rate* of decline was in the year December 1, 1952, to November 30, 1953. In that year appellee emitted 80% more fluorides than previously because it had expanded its production. As pointed out on page 14 of our brief, this expanded production meant an increase in escaping fluorides from 250 pounds per day to 450 pounds per day.

As to our above-quoted argument relating fluorine intake to milk production on the Whiteaker farm, appellee has no direct answer. The closest it gets is Dr. Garlick's views as quoted in its brief on pages 78-79:

“(1) WHITEAKER. As noted previously, Dr. Garlick did not discover any animals in this herd which had been injured by fluorosis. He visited the farm on July 11, 1951. Prior to doing so, he examined the herd's Dairy Herd Improvement Association production records. From this examination and said visit, he concluded (R-VII-1917-1922):

1. The primary problem was sterility;
2. Several animals were suffering from hoof rot;
3. Several heifers were barren;
4. One cow had a pronounced endocrine imbalance;
5. Three cows were 14 years of age or over and too old for production; and
6. Culling of marginal producers had been neglected.”

We pointed out on pages 80-82 of our brief in detail that, Dr. Garlick to the contrary notwithstanding, it is still

perfectly clear that the only variable in the Whiteaker's milk production history is the variable supplied by varying amounts of fluorine. Not only does appellee not answer that, it does not in any way touch upon our discussion of Dr. Garlick's views.

We take it that there is no question, really, but that milk production did vary on appellants' farms in accordance with fluorine consumed, particularly in the Rawnsley and Whiteaker instances. Fairly read, as we have just pointed out, there is nothing in appellee's brief which would lead this Court to any other conclusion.

The rest of appellee's Point II may be dealt with briefly. A 40-page section (Ap. Br. 30-70) deals with the argument that appellants failed to sustain the burden of proving that their cattle were injured. Pages 70-82 is to the point that in any event the proximate cause of the injury was not appellee's operation of the plant. Finally, appellee's brief (82-90) contains a series of nuisance cases to the effect that even if appellee's operation of the plants was the proximate cause of the cattle injury, no damages may be awarded because the utility of appellee's operations outweighs the gravity of the harm to appellants.

Perhaps the last point just mentioned should be discussed first. Appellee's supposed rule applies to injunctive relief, not damages (p. 7 this brief). In any event appellants are now contending and were contending in the trial Court appellee was trespassing. So much for that.

This brings us back to appellee's 40-page argument that the cattle weren't injured. In support of this, appellee points out that Drs. Phillips and Schmidt conducted experiments with sodium fluoride running up to 75 parts per million and that the cattle subjected to that level were not injured. Since that testimony, plus the observation of appellee's three veterinarians was the only defense offered at the trial, we anticipated that this defense would be briefed by appellee and answered it on pages 75-86 of our brief. It is too long to summarize here and we therefore ask the Court to re-read that section.

Appellee's detailed review of all of the claims, leaves out in each case the fact previously referred to that many samples were taken by appellee and others at points not on appellants' farms. Appellee ignores those results. Concerning the Baker claim (Ap. Br. top p. 45) appellee urges there was no appreciable variation in milk production. This, of course, overlooks the fact that Rex Ross, appellants' cattle expert, stated that production on the farms, including the Baker farm, should have been under normal conditions a lot higher than it was. Moreover, Dr. A. O. Shaw testified that adequate amounts of feed were supplied to maintain the production contended for. As to the Robson claim, appellee is at pains (p. 54) to point out that his income increased 50% during the years for which claim was made. A similar claim is made with respect to Mr. Hester (p. 49) and Mr. Ford (p. 48). This argument was anticipated and answered in the last paragraph on page 9 of our brief.

Appellee's curious habit of making statements in an answering brief, without reference as to what has already

been said in the opening brief, appears again in the discussion of the Seekins production on page 55. There appellee urges that in his deposition Mr. Seekins testified that his production was just what appellants' cattle expert said at the trial it ought to be. In our brief in the first full paragraph on page 48 we noted that Mr. Seekins testified at the trial that he wasn't trying to say in his deposition what his production was—he was saying what it ought to be. Similarly, appellee's argument with respect to Mr. Stauffer's culling starting in the last paragraph on page 56 of its brief was answered in the paragraph beginning at the bottom of page 50 of our brief.

Appellee urges that the Whiteaker cattle weren't injured, relying primarily upon the fact that the Phillips-Schmidt experimental levels were higher than the fluoride sample results obtained on the farms in the Whiteaker action. The soundness of this, of course, depends upon ignoring all of the considerations we urged in our brief leading to the conclusion the cattle were injured. It is probably worth adding, with respect to the Goldsmith claim, that appellee urges (p. 68) there was no butterfat loss because the production went up each year except for the last year. However, the decline in the last year was 25% which was the same year (as previously pointed out) that appellee's fluoride emanations increased by 80% or from 250 to 450 pounds per day.

Appellee finally claims that even though appellants' cattle were injured, appellee's activities were not the proximate cause thereof. This is developed at some length on pages 70-82 of appellee's brief. Two points are

probably worth answering: Appellee repeatedly refers to *presence* of disease as indicative of a *history* of disease. Of course, the choice of the word "history" indicates that the disease in question was a problem that was continuing on these farms all the time, or substantially so. The fact of the matter of course, is that except for Mr. Josephson, who really did have a Bangs disease problem in 1952, the other appellants suffered no more than the usual incidents of ordinary diseases in their cattle. Our brief pointed this out at pp. 8-9. The other matter probably worth mentioning is appellee's contention with respect to six of appellants that they were really getting their fluorine from mineral supplements. The mineral supplements referred to ranged from a maximum of 1340 ppm fluorine to a minimum of 30 ppm. In view of the facts that there is no evidence in the record as to how much mineral supplements were consumed nor that mineral supplements ever caused fluorosis anywhere, this seems a pretty slender reed to lean on. It is, in fact, an obvious makeweight.

After contending in Point II of its brief that appellants' cattle weren't injured and that appellee's operations were not the proximate cause of any injury, appellee contends that a remand would not be justified anyway. The legal basis for this argument is that appellee was not creating a nuisance (Ap. Br. 82-89). This abstract proposition of law has nothing to do with appellants' theory. As pointed out earlier in this brief (p. 14) appellants are proceeding upon the theory of trespass. Appellee does not contend that if it was trespassing damages should not be awarded.

REPLY TO APPELLEE'S POINT III

In contending that the deposit of particulates upon Washington lands is not a trespass (for the purpose of the law of limitations), appellee relies as did the trial Court, upon the *Riblet*, *Weller* and *Suter* cases (Ap. Br. 94, 95, 97). We pointed out (Br. 90-93) that the first two of these cases were pleaded in nuisance and that the last was pleaded in negligence.

Appellee also relies upon the *Perrin* and *Fraser* cases decided in the same Court in which the present cases were decided. Both involved Oregon lands and thus Oregon substantive law. Moreover, as shown by Judge Leavy's opinion in the *Perrin* case (Ap. Br. 93-94), he was dealing with fumes, not solids.

Appellee also cites (p. 96) the *Sterrett* case. This was a nuisance case. The theory of the *Park* case relied upon by appellee (p. 96) does not appear from the opinion, but the opinion does show that smoke and fumes were involved, not solids.

In attempting to distinguish the Washington trespass cases, the text writers and Judge Fee's opinions on trespass (Br. 95-100), appellee's principal contention is: "* * * There is no indication that the rules stated therein are to be applied to the settling upon real properties of minute materials emanating from an industrial plant being lawfully operated." (Ap. Br. 104) We think the answer to this is, as stated on p. 93 of our brief, "* * * it is not lawful in Washington or anywhere else to deposit solids on another's real property."

By Point III, 2, of its brief appellee contends that the Washington two-year statute applies to appellants' personalty claims. No attention at all is given to our argument that while the three-year personalty limitations statute has been held inapplicable to certain "person or rights" cases, such holdings have never been applied to cases which, like the present ones, involve personal property (Br. 100, 104). We can add nothing to that argument here.

Appellee concludes its brief (p. 109) by contending that since no trespass was made out and since no damage was shown remand is unnecessary because moot. It seems obvious that even granting appellee's assumptions for the sake of argument, no one knows what the proof would show as to the missing third year.

Respectfully submitted,

SCHAFER, CRONAN & NELSON,
JAMES P. CRONAN, JR.,
PAUL M. REEDER,

Of Attorneys for Appellants.



No. 14735

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

VS.

ROBERT H. MILLER and DORIS K. MILLER,

Respondents.

Transcript of Record

**Petition to Review a Decision of the Tax Court
of the United States**

FILED

JUL 20 1955

FRANK B. GERRIEN, CLERK

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[Clerk's Note: When deemed likely to be of an important nature. errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1952

Dec. 12—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 22—Copy of petition served on General Counsel.

1953

Feb. 17—Answer filed by General Counsel.

Feb. 17—Request for hearing in Los Angeles filed by General Counsel.

Feb. 25—Notice issued placing proceeding on Los Angeles, California, calendar, Service of answer and request made.

Aug. 28—Hearing set December 7, 1953, Los Angeles, California.

Nov. 12—Entry of appearance of Erwin Lampe as counsel filed.

Dec. 14—Hearing had before Judge Withey, on merits. Stipulation of facts and appearance of Max B. Lewis, Esq., filed. Briefs due 2/15/54. Replies due 3/17/54.

1954

Jan. 26—Brief filed by taxpayer.

Feb. 5—Motion for extension to March 15, 1954, to file brief filed by General Counsel. 2/8/54 Granted.

Mar. 15—Brief filed by General Counsel.

Mar. 16—Copy of taxpayer's brief served on General Counsel.

Mar. 18—Transcript of hearing, 12/14/53, filed.

Apr. 13—Motion for extension to April 30, 1954, to file reply brief filed by taxpayer. 4/13/54 Granted.

Aug. 17—Memorandum findings of fact and opinion filed, Withey, Judge. Decision will be entered under rule 50. Copy served.

Nov. 2—Agreed computation filed.

Nov. 8—Decision entered, Judge, Withey, Div. 4.

1955

Jan. 28—Petition for review by U. S. Court of Appeals, Ninth Circuit, with statement of points, filed by General Counsel.

Feb. 7—Proof of service filed. (Counsel.)

Feb. 15—Proof of service of petition for review filed. (Counsel.)

Feb. 15—Proof of service of petition for review filed. (Taxpayer.)

Feb. 28—Motion for extension to April 28, 1955, for filing the record and docketing the appeal filed by General Counsel.

Mar. 1—Order extending time to April 28, 1955, for filing the record and docketing the appeal, entered.

1955

Apr. 12—Proposed statement of points with notice of service by mail thereon filed by General Counsel.

Apr. 12—Designation of contents of record with notice of service by mail thereon filed by General Counsel.

The Tax Court of the United States

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies set forth by the said Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols LA:IT:90D:-CTF), dated October 31, 1952, and as a basis for their proceeding, allege as follows.

1. Petitioners are, and at all times mentioned herein were, husband and wife, with residence at 11459 Bellagio Road, Los Angeles, California. The return for the period the year 1948 and for the

period the year 1949 herein involved were filed with the Collector for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to the petitioners on October 31, 1952.

3. The deficiency, as determined by the Commissioner, is in income taxes for the calendar year 1948, in the amount of \$983.72, and in income taxes for the calendar year 1949, in the amount of \$9,454.06. The entire amount of the deficiency is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously increased petitioners' income for the year 1948 in the amount of \$2,941.74 by decreasing petitioner's distributive share of loss from the partnership I. W. Bosworth and Associates for its taxable year July 1, 1947, to January 31, 1948, by eliminating from allowable deductions rentals paid to the Treasurer of the United States under Section 17 of the Act of February 25, 1920 (41 Stat. 437), as amended by the Act of August 8, 1946 (60 Stat. 950), and filing fees paid under CFR Title 43, Chapter 1, Part 191.11, and recording fees.

(b) The Commissioner erroneously increased petitioners' income for the year 1949 in the amount of \$20,720.16 by decreasing petitioners' distributive share of loss from partnerships as follows:

I. Loss from I. W. Bosworth and Associates for the year ended January 31, 1949, reduced \$10,435.03 by eliminating from allowable deductions rentals paid to the Treasurer of the United States under Section 17 of the Act of February 25, 1920 (41 Stat. 437), as amended by the act of August 8, 1946 (60 Stat. 950), and filing fees paid under CFR Title 43, Chapter 1, Part 191.11, and recording fees.

II. Loss from Robert H. Miller and Associates for the period ended January 31, 1949, reduced \$1,898.83 by elimination of such rentals and fees.

III. Loss from Equity Oil Company for the period May 1, 1949, to December 31, 1949, reduced \$5,986.30 by the elimination of such rentals and fees.

IV. Loss from Robert H. Miller and Associates for the period February 1, 1949, to April 30, 1949, reduced \$2,400.00 by eliminating from allowable deductions delay lease rentals paid to hold fee land leasehold later abandoned, and by eliminating from allowable deductions filing and recording fees in connection with other properties to which title was never obtained.

(c) The Commissioner erroneously computed the amount of deficiency assessed by him, particularly in reference to the Equity Oil Company partnership in connection with which he has proposed disallowance of \$3,511.75 in excess of net lease rentals claimed, of which petitioners' share would be \$877.94

5. The facts upon which petitioners rely as the basis for their proceeding are as follows:

(a) The right to prospect and produce oil and gas on the public domain is granted by the Act of February 25, 1920 (41 Stat. 437), as amended. The Act of August 21, 1935 (49 Stat. 674), materially changed the original leasing act by granting the right to prospect for oil and gas under a lease, rather than under a prospecting permit. The Act of August 8, 1946 (60 Stat. 950), liberalized the provisions of the Act of August 21, 1935, *supra*, in order to encourage prospecting on the public domain and the discovery of new sources of supply of oil and gas.

(b) So far as oil and gas are concerned, the public domain is directly and completely divided into two general classifications: (1) Lands known to contain oil or gas in paying quantities, which are described as lands within any known geological structure of a producing oil or gas field, and (2) lands not known to contain oil or gas in paying quantities, commonly referred to as wildcat lands. In the latter classification, prospecting is necessary to determine whether the lands contain oil or gas in paying quantities, and to determine whether the lands have any value whatsoever, and the right to do such prospecting may be secured by obtaining a "non-competitive" lease from the Government. It is these prospecting rights or "non-competitive" leases which are herein involved.

(c) Section 17 of the Act of February 25, 1920, *supra*, as amended by Section 3 of the Act of August 8, 1946, sets forth the procedures to be followed by the Secretary of the Interior in leasing all lands subject to disposition under the Act. This Section of the Act reads: “* * * When the lands to be leased are within any known geologic structure of a producing oil or gas field, they shall be leased to the highest responsible qualified bidder * * * upon the payment of such bonus as may be accepted by the Secretary * * * When the lands are not within any known geological structure of a producing oil or gas field, the first person making application for the lease who is qualified to hold a lease under this Act shall be entitled to a lease of such lands without competitive bidding * * * All leases issued under this Section shall be conditioned upon the payment by lessee in advance of a rental of not less than 25 cents per acre per annum * * *”

(d) The Act requires the Secretary to collect a rental from all leases issued under the Act. In addition the Act empowers the Secretary to sell a lease on proven ground to the highest qualified bidder. The Act does not empower the Secretary to sell prospecting rights or “non-competitive” leases.

(e) Since these “non-competitive” leases cannot legally be sold by the Government, any taxing theory under which lessees’ rentals are to be capitalized as acquisition cost must start with the premise of placing lessee in a theoretical illegal position.

(f) That the usage by the Congress of the word "rentals" in the Land Act, and the usage by Congress of the word "rentals" in listing allowable deductions under the Internal Revenue Code was with the intent and understanding that the same meaning was intended in both instances and that these rentals paid to the Treasurer of the United States are deductible rentals under the Internal Revenue Code.

(g) The lease rentals on the Mott lease were rentals on a speculative fee lease which petitioners and associates did not drill and which lease was formally abandoned by permitting same to lapse at the end of its one-year life on March 12, 1950, and that from a business and economic standpoint the loss belongs in 1949 when rental was paid and when the decision not to drill was made by the partners in Robert H. Miller and Associates.

Wherefore, petitioners pray that this Court may hear the proceeding and determine that there is no deficiency in income tax against the petitioners for the calendar years 1948 and 1949.

/s/ ROBERT H. MILLER,
Petitioner.

/s/ DORIS K. MILLER,
Petitioner.

Duly verified.

EXHIBIT A

U. S. Treasury Department
Office of Internal Revenue Agent in Charge
417 South Hill Street
Los Angeles 13, California

Form 1230-A (1951)

Seal

October 31, 1952.

Internal Revenue Service,
Los Angeles District,
LA:IT:90D:CTF,

Mr. Robert H. Miller and
Mrs. Doris K. Miller,
Husband and wife,
1385 Westwood Boulevard,
Los Angeles 24, California.

Dear Mr. and Mrs. Miller:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948, and 1949, discloses a deficiency of \$10,437.78 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, at its principal address,

Exhibit A—(Continued)

Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

JOHN B. DUNLAP,

Commissioner;

By GEORGE D. MARTIN,

Internal Revenue Agent in
Charge.

Enclosures:

Statement.

Form 1276.

Agreement Form.

Exhibit A—(Continued)

Statement

LA:IT:90D:CTF

Mr. Robert H. Miller and

Mrs. Doris K. Miller

Husband and Wife

1385 Westwood Boulevard

Los Angeles 24, California

Tax Liability for the Taxable Years

Ended December 31, 1948 and 1949

Year	Deficiency
1948 Income tax	\$ 983.72
1949 Income tax	9,454.06
Total	<u>\$10,437.78</u>

In making this determination of your income tax liability careful consideration has been given to the report of examination dated October 15, 1951, to your protest dated December 3, 1951, and to the statements made at the conferences held.

Adjustment to Net Income

Taxable year ended December 31, 1948

Net income as disclosed by return\$22,569.36

Unallowable deduction:

(a) Partnership loss decreased 2,941.74

Net income adjusted\$25,511.10

Explanation of Adjustment

(a) The loss from partnership claimed in your return is decreased in the amount of \$2,941.74, computed as shown below.

Your correct distributive share of loss from the partnership I. W. Bosworth and Associates for its taxable year July 1, 1947, to January 31, 1948

(\$65.34)

Amount claimed(3,007.08)

Decrease\$2,941.74

It is held that amounts, included in the decrease of loss stated above, deducted as "rental expense," representing payments made under United States Government oil and gas leases do not constitute proper deductions under the provisions of Section 23(a) of the Internal Revenue Code.

Exhibit A—(Continued)

Computation of Tax
Taxable Year Ended December 31, 1948

Net income adjusted	\$25,511.10
Less Exemptions	2,400.00
<hr/>	
Balance, subject to surtax and normal tax....	\$23,111.10
One-half of \$23,111.10	\$11,555.55
Tentative tax	\$3,231.11
Less reduction under Sec. 12 (c), I. R. C.	407.73
<hr/>	
Total tax on one-half of net income	\$ 2,823.38
Combined tax (\$2,823.38 x 2)	\$ 5,646.76
Correct income tax liability	\$ 5,646.76
Income tax liability shown on return, account No. 9110733	\$ 4,663.04
<hr/>	
Deficiency in income tax	\$ 983.72

Adjustment to Net Income
Taxable Year Ended December 31, 1949

Net income as disclosed by return	\$28,039.72
Unallowable deduction:	
(a) Partnership loss decreased	20,720.16
<hr/>	
Net income adjusted	\$48,759.88

Explanation of Adjustment

(a) The loss claimed in your return from the following partnerships is decreased in the amount of \$20,720.16, computed as shown below:

Partnership	Taxable Year	Your Distributive Share	
		As Determined	Claimed
Equity Oil	May 1, 1949 to		
Company	Dec. 31, 1949....	\$(226.80)	\$(6,213.10)
I. W. Bosworth	Ended Jan. 31,		
& Associates	1949	(1,702.97)	(12,138.00)
Robert H. Miller	Aug. 1, 1948 to		
& Associates	Jan. 31, 1949....	(165.46)	(2,064.29)
Robert H. Miller	Feb. 1, 1949 to		
& Associates	Apr. 30, 1949....	(12.50)	(2,412.50)
<hr/>			
Total		\$(2,107.73)	\$(22,827.89)
Decrease		\$(20,720.16)	

Exhibit A—(Continued)

It is held that amounts, included in the decrease of loss stated above, deducted as "rental expense," representing payments made under United States Government oil and gas leases do not constitute proper deductions under the provisions of Section 23(a) of the Internal Revenue Code.

Computation of Tax

Taxable Year Ended December 31, 1949

Net income adjusted	\$48,759.88
Less: Exemptions	1,800.00
<hr/>	
Balance, subject to surtax and normal tax ..	\$46,959.88
One-half of \$46,959.88	\$23,479.94
Tentative tax	\$9,253.17
Less reduction under Sec. 12(c) I. R. C.	1,130.38
<hr/>	
Total tax on one-half of net income	\$ 8,122.79
Combined tax (\$8,122.79 x 2)	\$16,245.58
Correct income tax liability	\$16,245.58
Income tax liability shown on return, account No. 3208623	6,791.52
<hr/>	
Deficiency of income tax	\$ 9,454.06

Received and filed December 12, 1952, T.C.U.S.

Served December 22, 1952.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayers, admits and denies as follows:

1. Admits that the petitioners are husband and wife, and that the returns for the years 1948 and 1949 herein involved were filed with the Collector for the Sixth District of California; denies the remaining allegations contained in paragraph 1 of the petition.

2 and 3. Admits the allegations contained in paragraphs 2 and 3 of the petition.

4. Denies the allegations of error contained in paragraph 4 of the petition and all subparagraphs and subdivisions thereof.

5. Denies the allegations contained in paragraph 5 of the petition and all subparagraphs thereof.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES W. DAVIS, E.C.C.,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
District Counsel.

E. C. CROUTER,
Appellate Counsel.

FRANCIS B. CAMPBELL, JR.,
Special Attorney, Bureau of Internal Revenue.

Received and filed February 17, 1953. T.C.U.S.

[Title of Tax Court and Cause.]

MEMORANDUM FINDINGS OF FACT
AND OPINION

Withey, Judge:

The respondent determined deficiencies of \$983.72 and \$9,454.06 in the income tax of the petitioners for 1948 and 1949, respectively. The only issues for determination are (1) whether first year payments made on non-competitive oil and gas leases issued by the United States were deductible as rentals, and (2) whether filing fees paid in connection with applications made for non-competitive oil and gas leases were deductible as business expenses in the years of payment. All other issues have been disposed of by stipulation of the parties.

Findings of Fact

The facts have been stipulated and are found accordingly.

The petitioners are, and were during 1948 and 1949, husband and wife and residents of Los Angeles, California. The petitioners filed joint income tax returns, prepared on the cash receipts and disbursements basis, for 1948 and 1949 with the collector for the sixth district of California.

Robert H. Miller, sometimes hereinafter referred to as the petitioner, is a geologist and is, and has been, engaged in various enterprises in the oil and gas field.

Under date of July 1, 1947, the petitioner, I. W. Bosworth and Glenn C. Ferguson formed a partnership, with each having a one-third interest, known as I. W. Bosworth and Associates, and sometimes hereinafter referred to as the Bosworth partnership. Under date of August 1, 1948, petitioner, I. W. Bosworth and Glenn C. Ferguson formed a partnership, with each having a one-third interest, known as Robert H. Miller and Associates, and sometimes hereinafter referred to as the Miller partnership. Under date of May 1, 1949, petitioner, I. W. Bosworth, Glenn C. Ferguson and J. N. Huber formed a partnership, with each having a one-fourth interest, known as Equity Oil Company, and sometimes hereinafter referred to as the Equity partnership. All the foregoing partnerships were formed for the purpose of acquiring oil and gas leases for investment and development. Each of the partnerships reported its income on the cash receipts and disbursements basis.

During the years involved herein the above-mentioned partnerships acquired non-competitive oil and gas leases on United States Government lands. All of the leases were issued pursuant to the authority of the Leasing Act of 1920 (41 Stat. 437), as amended. Applications for such leases, accompanied by a filing fee of \$10, were made by the respective partnerships through their individual members, and the leases when issued were executed by the partnerships, through their individual members, and

on behalf of the United States Government by a properly authorized official.

During its fiscal year ended January 31, 1948, the Bosworth partnership paid filing fees of \$173 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling \$8,652.22. In determining the amount of the petitioner's distributive share of the partnership's loss for the partnership's fiscal year ended January 31, 1948, to be allowed as a deduction in the petitioners' income tax return for 1948, the respondent determined that said fees and first year payments totaling \$8,825.22 were not allowable deductions.

During its fiscal year ended January 31, 1949, the Bosworth partnership paid filing fees of \$333 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling \$30,972.08, or a total of \$31,305.38. During its fiscal period ended January 31, 1949, the Miller partnership paid filing fees of \$312 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling \$5,384.50, or a total of \$5,696.50. During the period beginning May 1, 1949, and ended December 31, 1949, the Equity partnership paid filing fees of \$330 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling \$20,103.44, or a

total of \$20,433.44. In determining the amount of the petitioner's distributive share of the partnership loss from the foregoing partnerships to be allowed as deductions in the petitioners' income tax return for 1949, the respondent determined that said filing fees and first year payments were not allowable deductions.

The non-competitive oil and gas leases obtained by the various partnerships and involved herein contained the following:

Section 1. Rights of Lessee—That the lessor, in consideration of rents and royalties to be paid, and the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the lessee the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits except helium gas in or under the following-described tracts of land * * * together with the right to construct and maintain thereupon all works, buildings, plants, waterways, roads, telegraph or telephone lines, pipe lines, reservoirs, tanks, pumping stations, or other structures necessary to the full enjoyment thereof, for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities * * *.

Opinion

The first issue for determination is whether the first year payments made by the various partnerships on the non-competitive oil and gas leases ob-

tained by them from the United States were deductible by them as rentals. The petitioners contend that the payments were so deductible while the respondent contends that the payments constituted capital expenditures and were not deductible as rentals. On brief, filed prior to our decision in *Olen F. Featherstone*, 22 T.C. . . . No. 96 (filed June 30, 1954), the respondent directs our attention to that proceeding and states that the payments here involved were made under the same type of United States Government leases as were in issue there. From an examination of the leases in evidence in the instant proceeding, the foregoing statement of the respondent appears to be correct. In the *Featherstone* case, we held that the first year payments made on the non-competitive oil and gas leases issued by the United States and there involved were true rentals and were deductible as such by the payors. However, we pointed out that our holding was not necessarily dispositive of a case in which the payment claimed by the taxpayer as a deductible expense (or determined by the Commissioner as non-depletable income) is made in respect of a year in which mineral is produced in paying quantities. The instant proceeding was submitted on a stipulation of facts which makes no mention of any production at any time from any of the leases here involved. Consequently, for present purposes we conclude that none of the payments here in question were in respect of a year in which mineral was produced in paying quantities. In view of what has been said above, we think our holding in the *Featherstone* case is ap-

plicable and controlling here. Accordingly, we hold for the petitioners on this issue. See *United States v. Dougan* (C.A. 10) F. 2d, decided July 8, 1954.

The remaining issue is whether filing fees paid by the various partnerships in connection with applications made for non-competitive oil and gas leases constituted deductible business expenses for the years in which paid. The respondent contends that since the filing fees were paid upon application for leases with a primary term of five years with a possible term beyond that period, the fees were capital expenditures and as such were not deductible as business expenses. Aside from merely stating that the question of the deductibility of the fees was in issue in the proceeding, the petitioners make no further mention of the matter on brief. Other than showing that the fees accompanied applications made for non-competitive oil and gas leases, the record is silent as to the fees, the circumstances under which they were paid, whether leases were issued pursuant to such application, and, if so, what the term or terms of such leases were. In the state of the record, the respondent's action in determining that the fees were not deductible expenses is sustained for lack of proof to show error.

Decision will be entered under Rule 50.

Received August 9, 1954.

Served August 17, 1954.

Filed August 17, 1954.

The Tax Court of the United States, Washington

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

DECISION

Pursuant to the determination of this Court, as set forth in its Memorandum Findings of Fact and Opinion, filed August 17, 1954, the parties filed an agreed computation for entry of decision. In accordance with said computation, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$19.26 and \$122.64.

[Seal] /s/ G. G. WITHEY,
Judge.

Entered November 8, 1954.

Served November 9, 1954.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto through their respective counsel, that the following facts are true and may be found as facts by The Tax Court of the United States:

1. Petitioners are and were, during the years hereto involved, husband and wife, and residents of Los Angeles, California. Petitioner, Robert H. Miller, is a geologist and is and has been engaged in various enterprises in the oil and gas field.

2. Petitioners filed joint Federal income tax returns, Form 1040, for the calendar years 1948 and 1949, with the Collector of Internal Revenue for the Sixth District of California. Copies of said returns are attached hereto and marked Exhibits 1-A and 2-B. respectively.

3. Under date of July 1, 1947, petitioner, Robert H. Miller, together with I. W. Bosworth and Glenn C. Ferguson, entered into a partnership known as I. W. Bosworth and Associates for the purpose of acquiring oil and gas leases for investment and development, each of the partners having an equal share in the business. A partnership return, Form 1065, covering the period from July 1, 1947, to January 31, 1948, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is at-

tached hereto and marked Exhibit 3-C. A partnership return, Form 1065, covering the period from February 1, 1948, to January 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 4-D.

4. Under date of August 1, 1948, petitioner, Robert H. Miller, together with I. W. Bosworth and Glenn C. Ferguson, entered into a partnership known as Robert H. Miller and Associates, for the purpose of acquiring oil and gas leases for investment and development, each partner having an equal share in said business. A partnership return, Form 1065, covering the period from August 1, 1948, to January 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 5-E. A partnership return, Form 1065, covering the period from February 1, 1949, to April 30, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 6-F. Said partnership was terminated on April 30, 1949.

5. Under date of May 1, 1949, petitioner, Robert H. Miller, together with I. W. Bosworth, Glenn C. Ferguson and J. N. Huber entered into a partnership known as Equity Oil Company for the purpose of acquiring oil and gas leases for investment and development, each partner having an equal share

in said business. A partnership return, Form 1065, covering the period May 1, 1949, to December 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 7-G.

6. The petitioners herein, and the partnerships heretofore mentioned, all reported their income on the cash receipts and disbursements basis.

7. All of the partnerships hereinabove referred to acquired so-called "non-competitive" oil and gas leases on United States Government lands during the taxable periods herein involved. The Administration of such Government lands is governed by the Act of February 24, 1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas and sodium on the public domain," as amended (41 Stat. 437) and the regulations promulgated thereunder, specifically Title 43, Chapter 1, Part 192, Code of Federal Regulations.

8. In connection with the acquisition of the oil and gas leases above referred to, the partnerships, through their individual partners, filed "Applications for Oil and Gas Leases," pursuant to the procedure prescribed in the above-mentioned Statute and regulation. Illustrative copies of said "Application" forms are attached hereto and marked Exhibits 8-H and 9-I.

9. In connection with the oil and gas leases acquired by said partnerships during said taxable

periods, Form 4-213, "Lease of Oil and Gas Lands Under the Act of February 25, 1920, as Amended," were executed by the partnerships, through their partners, and on behalf of the United States Government by a properly authorized official. Copies of said forms are attached hereto and marked Exhibits 10-J and 11-K.

10. During the fiscal year ended January 31, 1949, the partnership, I. W. Bosworth and Associates, in entering into such "non-competitive" oil and gas leases with the United States Government presented "Applications for Oil and Gas Leases" and paid filing fees therewith in the amount of \$173.00. The partners subsequently entered into "non-competitive" leases of oil and gas lands with the United States Government, which leases provided for the payments of "rentals" in advance "for the first lease year, a rental of 50 cents per acre." During the partnership year ended January 31, 1948, said partnership paid such lease "rentals" in the amount of \$8,652.22. The partnership deducted such filing fees in the amount of \$173.00, and such "rental" payments in the amount of \$8,652.22 on its income tax return filed for the taxable period ending January 31, 1948. Respondent has held that such filing fees are a part of the cost of the lease and as such are a capital expenditure and that the "rental" payments for the first year constitute a lease bonus and as such constitute a capital charge. Respondent has held that the loss of I. W. Bosworth & Associates for this period ended January

31, 1948, should be reduced to \$196.00, of which petitioners' share would be \$65.34.

11. Respondent determined that petitioners' distributive share of losses from certain partnerships engaged in the business of acquiring oil and gas leases for investment and development should be reduced from \$22,827.89 as claimed in petitioners' 1949 joint income tax return to \$2,107.73 and that petitioners' taxable income should be increased by \$20,720.16 with a resulting additional tax of \$9,454.06. Such partnerships comprise the following:

Name	Period Ending	Loss Claimed by Petitioners	Loss Allowed by Respondent
Equity Oil Company.....	12-31-49	\$ 6,213.10	\$ 226.80
I. W. Bosworth & Associates.....	1-31-49	12,138.00	1,702.97
Robert H. Miller & Associates....	1-31-49	2,064.29	165.46
Robert H. Miller & Associates....	4-30-49	2,412.50	12.50
Total.....		\$22,827.89	\$2,107.73

Petitioners' distributive share of adjustments as determined by respondent, \$20,720.16.

12. For the fiscal year ended January 31, 1949, the partnership, I. W. Bosworth and Associates, filed its return showing as ordinary net income a loss of \$36,413.99, and \$12,138.00 of such loss as petitioners' distributive share thereof. During said I. W. Bosworth and Associates fiscal year ended January 31, 1949, said partnership paid fees in the amount of \$333.00 in connection with the filing of "Applications for Oil and Gas Leases" and paid First lease year "Rentals" on "non-competitive"

United States Government Leases of Oil and Gas Lands in the amount of \$30,972.08. Such filing fees and "rental" payments were taken as deductions in said partnership return and respondent has determined that these items should be capitalized and that this partnership's ordinary loss should be reduced to \$5,108.91 and that petitioners' distributive share of such loss should be \$1,702.97.

13. For the period ending January 31, 1949, the partnership, Robert H. Miller and Associates, reported a loss of \$6,192.87 and respondent has determined that deductions included in such loss should be reduced in the sum of \$5,696.50 through capitalizing filing fees in the amount of \$312.00 and first year "rentals" in the amount of \$5,384.50 both of these items relating to "non-competitive" Government were as follows:

14. For the fiscal period February 1, 1949, through April 30, 1949, the partnership of Robert H. Miller and Associates reported a net loss of \$7,237.50 with petitioners' share of such loss reported as \$2,412.50. Respondent determined that such loss should be reduced by \$7,200.00 and that petitioners' share of such loss should be reduced to \$12.50. Items involved in this \$7,200.00 adjustment oil and gas leases. Elimination of such deductions would result in reducing petitioners' share of loss from \$2,064.29 as claimed by petitioners to a loss of \$165.46 as determined by respondent for the partnership taxable year ended January 31, 1949.

Lease Rentals	\$7,500.00
Filing Fees	80.00

Sub-total\$7,580.00

Less Lease Rentals Refunded Reported
as Income by Petitioner and Eliminated
Therefrom by Respondent...\$ 380.00

Net Adjustment\$7,200.00

The \$7,500.00 lease rentals item represents payment made in connection with the acquisition of a lease on a parcel of privately owned fee land identified as the Mott Lease. This transaction was not like the transactions relating to "non-competitive" Government oil and gas leases and it is agreed that such payment for the Mott Lease is to be capitalized for the year 1949 without prejudice to petitioners' right to recover such cost upon proof of abandonment of said lease in 1950. Filing fees deducted during the period ending April 30, 1949, relate to fee land lease proposals in connection with leases on fee lands, privately owned. No property acquisition followed and these are a proper deduction for this partnership in this period. This stipulation is without prejudice to the position of petitioners or respondent in reference to capitalization or expensing of filing fees on "non-competitive" Government leases.

15. During the period February 1, 1949, to April 30, 1949, the Robert H. Miller and Associates partnership received a refund of \$380.00 in connection

with one of the Government "non-competitive" oil and gas leases due to a dispute as to title on one of its leases. Said partnership had reported the lease "rental" as a deduction during its year ended January 31, 1949, and showed the refund as income on its return for the period ending April 30, 1949. Respondent has determined that the deduction claimed should be capitalized for the period ended January 31, 1949, and consistently that this refund is a refund of capital and not income. If petitioners prevail and "rentals" of "non-competitive" United States Government oil and gas leases are not to be capitalized, then these refunds are income.

16. The partnership, Equity Oil Company, filed its first return for the period ending December 31, 1949, and showed a loss of \$24,852.38 with petitioners' distributive share reported as \$6,213.10. Respondent determined that filing fees of \$330.00 and first year "rentals" of \$23,615.19 relating to United States Government "non-competitive" oil and gas leases should be capitalized and reduced the loss to \$907.19, of which petitioners' distributive share of loss would be \$226.80. This partnership devoted part of its activities to securing a complete block of leases in one area for a compact drilling unit of land. This included certain lands where titles were uncertain and involved. This partnership did pay out lease "rentals" in the amount of \$23,615.19 as set out above, but of this amount \$3,511.75 was refunded during the period by the Bureau of Land Management which held that it could not properly

issue leases on lands involving this amount of "rentals" because of disputes over priority, survey lines, miners' rights and other complications. For bookkeeping purposes, this partnership kept such refunds in a separate account instead of showing same as an offset to "rentals" expense. The partnership return was filed showing income from return "rentals" as \$3,511.75 and "rental" expense as \$23,615.19. The amount at issue is \$20,103.44, although respondent used \$23,615.19 in the determination of the adjustment of this partnership's loss. If respondent prevails, proper adjustment shall be made in determining deficiency under Rule 50.

17. The issues involved are whether payments made for "first year lease rentals" on United States Government "non-competitive" leases are deductible "rentals" or whether such payments constitute a lease bonus and, as such represent capital expenditures, and the incidental issue as to whether or not filing fees paid in connection with the filing of "Applications for Oil and Gas Leases" are deductible expenses or a capital expenditure.

/s/ ERWIN LAMPE,

Counsel for Petitioners.

/s/ DANIEL A. TAYLOR, E.C.C.,

Chief Counsel, Internal Revenue Service, Counsel
for Respondent.

EXHIBIT 11-K

Form 4-213

(August, 1948)

United States

Department of the Interior

Bureau of Land Management

Office: Carson City.

Serial: 023897.

Abstracted & Audited.

Non-competitive

Lease of Oil and Gas Lands Under the Act of
February 25, 1920, as Amended

This Indenture of Lease, entered into, in triplicate, as of the 1st day of Nov., 1949, by and between the United States of America, through the Bureau of Land Management, party of the first part, and Robert H. Miller, 1385 Westwood Blvd., Los Angeles 24, California, party of the second part, hereinafter called the lessee, under, pursuant, and subject to the terms and provisions of the act of February 25, 1920 (41 Stat. 437), as amended, hereinafter referred to as the act, and to all reasonable regulations of the Secretary of the Interior now or hereafter in force when not inconsistent with any express and specific provisions herein, which are made a part hereof.

Witnesseth:

Section 1. Rights of Lessee—That the lessor, in consideration of rents and royalties to be paid, and

(Exhibit 11-K—Continued)

the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the lessee the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits except helium gas in or under the following-described tracts of land:

T. 17 N., R. 58 E., M.D.M., Nevada,
Sec. 10, S1½.
Section 31, All.

containing 962.60 acres, more or less, together with the right to construct and maintain thereupon all works, buildings, plants, waterways, roads, telegraph or telephone lines, pipe lines, reservoirs, tanks, pumping stations, or other structures necessary to the full enjoyment thereof, for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities; subject to any unit agreement heretofore or hereafter approved by the Secretary of the Interior, the provisions of said agreement to govern the lands subject thereto where inconsistencies with the terms of this lease occur.

Sec. 2. In consideration of the foregoing, the lessee hereby agrees:

(a) Bonds—(1) To maintain any bond furnished by the lessee as a condition for the issuance of this lease. (2) If the lease is issued non-competitively, to furnish a bond in a sum double the amount of the \$1 per acre annual rental, but not less than \$1,000 nor more than \$5,000, upon the inclusion of

(Exhibit 11-K—Continued)

any part of the leased land within the geologic structure of a producing oil or gas field. (3) To furnish prior to beginning of drilling operations and maintain at all times thereafter as required by the lessor a bond in the penal sum of \$5,000 with approved corporate surety, or with deposit of United States bonds as surety therefor, conditioned upon compliance with the terms of this lease, unless a bond in that amount is already being maintained or unless such a bond furnished by an approved operator of the lease is accepted.

Until a general lease bond is filed a non-competitive lessee will be required to furnish and maintain a bond in the penal sum of not less than \$1,000 in those cases in which a bond is required by law for the protection of the owners of surface rights. In all other cases where a bond is not otherwise required, a \$1,000 bond must be filed for compliance with the lease obligations not less than 90 days before the due date of the next unpaid annual rental, but this requirement may be successively dispensed with by payment of each successive annual rental not less than 90 days prior to its due date.

(b) Co-operative or unit plan—Within 30 days of demand, or if the land is within an approved unit plan, in the event such a plan is terminated prior to the expiration of this lease, within 30 days of demand made thereafter, to subscribe to and to operate under such reasonable co-operative or unit plan for the development and operation of the area, field.

(Exhibit 11-K—Continued)

or pool, or part thereof, embracing the lands included herein as the Secretary of the Interior may determine to be practicable and necessary or advisable, which plan shall adequately protect the rights of all parties in interest, including the United States.

(c) Wells—(1) To drill and produce all wells necessary to protect the leased land from drainage by wells on lands not the property of the lessor or lands of the United States leased at a lower royalty rate, or in lieu of any part of such drilling and production, with the consent of the Director of the Geological Survey, to compensate the lessor in full each month for the estimated loss of royalty through drainage in the amount determined under instructions of said Secretary; (2) at the election of the lessee, to drill and produce other wells in conformity with any system of well spacing or production allotments affecting the field or area in which the leased lands are situated, which is authorized and sanctioned by applicable law or by the Secretary of the Interior; and (3) promptly after due notice in writing to drill and produce such other wells as the Secretary of the Interior may require to insure diligence in the development and operation of the property.

(d) Rentals and royalties—(1) To pay the rentals and royalties set out in the rental and royalty schedule attached hereto and made a part hereof.

(Exhibit 11-K—Continued)

(2) It is expressly agreed that the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty on any or all oil, gas, natural gasoline, and other products obtained from gas; due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters and whenever appropriate, after notice and opportunity to be heard.

(3) When paid in value, such royalties on production shall be due and payable monthly on the last day of the calendar month next following the calendar month in which produced. When paid in amount of production, such royalty products shall be delivered in merchantable condition on the premises where produced without cost to lessor, unless otherwise agreed to by the parties hereto, at such times and in such tanks provided by the lessee as reasonably may be required by the lessor, but in no case shall the lessee be required to hold such royalty oil or other products in storage beyond the last day of the calendar month next following the calendar month in which produced. The lessee shall not be responsible or held liable for the loss or destruction of royalty oil or other products in storage from causes over which he has no control.

(4) Royalties shall be subject to reduction on the entire leasehold or on any portion thereof segre-

(Exhibit 11-K—Continued)

gated for royalty purposes if the Secretary of the Interior finds that the lease cannot be successfully operated upon the royalties fixed herein, or that such action will encourage the greatest ultimate recovery of oil or gas or promote conservation.

(e) Contracts for disposal of products—Not to sell or otherwise dispose of oil, gas, natural gasoline, and other products of the lease except in accordance with a contract or other arrangement first approved by the Director of the Geological Survey or his representative, such approval to be subject to review by the Secretary of the Interior but to be effective unless and until revoked by the Secretary or the approving officer, and to file with such officer all contracts or full information as to other arrangements for such sales.

(f) Statements, plats, and reports—At such times and in such form as the lessor may prescribe, to furnish detailed statements showing the amounts and quality of all products removed and sold from the lease, the proceeds therefrom, and the amounts used for production purposes or unavoidably lost; a plat showing development work and improvements on the leased lands and a report with respect to stockholders, investment, depreciation, and costs.

(g) Well records—To keep a daily drilling record, a log, and complete information on all well surveys and tests in form acceptable to or prescribed by the lessor of all wells drilled on the leased lands,

(Exhibit 11-K—Continued)

and an acceptable record of all subsurface investigations affecting said lands, and to furnish them, or copies thereof to the lessor when required.

(h) Inspection—To keep open at all reasonable times for the inspection of any duly authorized officer of the Department, the leased premises and all wells, improvements, machinery, and fixtures thereon and all books, accounts, maps, and records relative to operations and surveys or investigations on the leased lands or under the lease.

(i) Payments—Unless otherwise directed by the Secretary of the Interior, to make rental, royalty, or other payments to the lessor, to the order of the Treasurer of the United States, such payments to be tendered to the manager of the district land office in the district in which the lands are located or to the Director of the Bureau of Land Management if there is no district land office in the State in which the lands are located.

(j) Diligence—Prevention of waste—Health and safety of workmen—To exercise reasonable diligence in drilling and producing the wells herein provided for unless consent to suspend operations temporarily is granted by the lessor; to carry on all operations in accordance with approved methods and practice as provided in the operating regulations, having due regard for the prevention of waste of oil or gas or damage to deposits or formations containing oil, gas, or water or to coal measures or

(Exhibit 11-K—Continued)

other mineral deposits, for conservation of gas energy, for the preservation and conservation of the property for future productive operations, and for the health and safety of workmen and employees; to plug properly and effectively all wells before abandoning the same; to carry out at expense of the lessee all reasonable orders of the lessor relative to the matters in this paragraph, and that on failure of the lessee so to do the lessor shall have the right to enter on the property and to accomplish the purpose of such orders at the lessee's cost: Provided, that the lessee shall not be held responsible for delays or casualties occasioned by causes beyond lessee's control.

(k) Taxes and wages—Freedom of purchase—To pay, when due, all taxes lawfully assessed and levied under the laws of the State or the United States upon improvements, oil, and gas produced from the lands hereunder, or other rights, property, or assets of the lessee; to accord all workmen and employees complete freedom of purchase, and to pay all wages due workmen and employees at least twice each month in the lawful money of the United States.

(1) Nondiscrimination — Not to discriminate against any employee or applicant for employment because of race, creed, color, or national origin, and to require an identical provision to be included in all subcontracts.

(m) Assignment of oil and gas lease or interest

(Exhibit 11-K—Continued)

therein—To file within 90 days from the date of final execution any instrument of transfer made of this lease, or any interest therein, including assignments of record title, working or royalty interests, operating agreements and subleases for approval, such instrument to take effect upon its final approval by the Director, Bureau of Land Management, as of the first day of the lease month following the date of filing in the proper land office.

(n) Pipelines to purchase or convey at reasonable rates and without discrimination—If owner, or operator, or owner of a controlling interest in any pipeline or of any company operating the same which may be operated accessible to the oil or gas derived from lands under this lease, to accept and convey and, if a purchaser of such products, to purchase at reasonable rates and without discrimination the oil or gas of the Government or of any citizen or company not the owner of any pipeline, operating a lease or purchasing or selling oil, gas, natural gasoline, or other products under the provisions of the act.

(o) Reserved deposits—To comply with all statutory requirements and regulations thereunder, if the lands embraced herein have been or shall hereafter be disposed of under the laws reserving to the United States the deposits of oil and gas therein, subject to such conditions as are or may hereafter be provided by the laws reserving such oil or gas.

(Exhibit 11-K—Continued)

(p) Reserved or segregated lands—If any of the land included in this lease is embraced in a reservation or segregated for any particular purpose, to conduct operations thereunder in conformity with such requirements as may be made by the Director, Bureau of Land Management, for the protection and use of the land for the purpose for which it was reserved or segregated, so far as may be consistent with the use of the land for the purpose of this lease, which latter shall be regarded as the dominant use unless otherwise provided herein or separately stipulated.

(q) Overriding royalties—To limit the obligation to pay overriding royalties or payments out of production in excess of 5 per cent to periods during which the average production per well per day is more than 15 barrels on an entire leasehold or any part of the area thereof or any zone segregated for the computation of royalties.

(r) Deliver premises in cases of forfeiture—To deliver up the premises leased, with all permanent improvements thereon, in good order and condition in case of forfeiture of this lease; but this shall not be construed to prevent the removal, alteration, or renewal of equipment and improvements in the ordinary course of operations.

Sec. 3. The lessor expressly reserves:

(a) Rights reserved—Easements and rights-of-way—The right to permit for joint or several use

(Exhibit 11-K—Continued)

easements or rights-of-way, including easements in tunnels upon, through, or in the lands leased, occupied, or used as may be necessary or appropriate to the working of the same or of other lands containing the deposits described in the act, and the treatment and shipment of products thereof by or under authority of the Government, its lessees or permittees, and for other public purposes.

(b) Disposition of surface—The right to lease, sell, or otherwise dispose of the surface of any of the lands embraced within this lease which are owned by the United States under existing law or laws hereafter enacted, insofar as said surface is not necessary for the use of the lessee in the extraction and removal of the oil and gas therein.

(c) Monopoly and fair prices—Full power and authority to promulgate and enforce all orders necessary to insure the sale of the production of the leased lands to the United States and to the public at reasonable prices, to protect the interests of the United States, to prevent monopoly, and to safeguard the public welfare.

(d) Helium—Pursuant to section 1 of the act, and section 1 of the act of March 3, 1927 (44 Stat. 1387), as amended, the ownership and the right to extract helium from all gas produced under this lease, subject to such rules and regulations as shall be prescribed by the Secretary of the Interior. In case the lessor elects to take the helium the lessee

(Exhibit 11-K—Continued)

shall deliver all gas containing same, or portion thereof desired, to the lessor at any point on the leased premises in the manner required by the lessor, for the extraction of the helium in such plant or reduction works for that purpose as the lessor may provide, whereupon the residue shall be returned to the lessee with no substantial delay in the delivery of gas produced from the well to the purchaser thereof. The lessee shall not suffer a diminution of value of the gas from which the helium has been extracted, or loss otherwise, for which he is not reasonably compensated, save for the value of the helium extracted. The lessor further reserves the right to erect, maintain, and operate any and all reduction works and other equipment necessary for the extraction of helium on the premises leased.

(e) Taking of royalties—All rights pursuant to section 36 of the act, to take royalties in amount or in value of production.

(f) Casing—All rights pursuant to section 40 of the act to purchase casing and lease or operate valuable water wells.

(g) Fissionable materials—Pursuant to the provisions of the act of August 1, 1946 (Public Law 585, 79th Congress), all uranium, thorium, or other material which has been or may hereafter be determined to be peculiarly essential to the production of fissionable materials, whether or not of commercial value, together with the right of the United

(Exhibit 11-K—Continued)

States through its authorized agents or representatives at any time to enter upon the land and prospect for, mine and remove the same, making just compensation for any damage or injury occasioned thereby.

Sec. 4. Drilling and producing restrictions—It is covenanted and agreed that the rate of prospecting and developing and the quantity and rate of production from the lands covered by this lease shall be subject to control in the public interest by the Secretary of the Interior, and in the exercise of his judgment the Secretary may take into consideration, among other things, Federal laws, State laws, and regulations issued thereunder, or lawful agreements among operators regulating either drilling or production, or both. After unitization, the Secretary of the Interior, or any person, committee, or State or Federal officer or agency so authorized in the unit plan, may alter or modify from time to time, the rate of prospecting and development and the quantity and rate of production from the lands covered by this lease.

Sec. 5. Surrender and termination of lease—The lessee may surrender this lease or any legal subdivision thereof by filing in the proper land office a written relinquishment, in triplicate, which shall be effective as of the date of filing subject to the continued obligation of the lessee and his surety to make payment of all accrued rentals and royalties

(Exhibit 11-K—Continued)

and to place all wells on the land to be relinquished in condition for suspension or abandonment in accordance with the regulations and the terms of the lease, to be accompanied by a statement that all wages and moneys due and payable to the workmen employed on the land relinquished have been paid.

Sec. 6. Purchase of materials, etc., on termination of lease.—Upon the expiration of this lease, or the earlier termination thereof pursuant to the last preceding section, the lessor or another lessee may, if the lessor shall so elect within 3 months from the termination of the lease, purchase all materials, tools, machinery, appliances, structures, and equipment placed in or upon the land by the lessee, and in use thereon as a necessary or useful part of an operating or producing plant, on the payment to the lessee of such sum as may be fixed as a reasonable price therefor by a board of three appraisers, one of whom shall be chosen by the lessor, one by the lessee, and the other by the two so chosen; pending such election all equipment shall remain in normal position. If the lessor, or another lessee, shall not within 3 months elect to purchase all or any part of such materials, tools, machinery, appliances, structures, and equipment, the lessee shall have the right at any time, within a period of 90 days thereafter to remove from the premises all the material, tools, machinery, appliances, structures, and equipment which the lessor shall not have elected to purchase, save and except casing in wells and other equipment or appara-

(Exhibit 11-K—Continued)

tus necessary for the preservation of the well or wells. Any materials, tools, machinery, appliances, structures, and equipment, including casing in or out of wells on the leased lands, shall become the property of the lessor, on expiration of the period of 90 days above referred to or such extension thereof as may be granted on account of adverse climatic conditions throughout said period.

Sec. 7. Proceedings in case of default.—If the lessee shall not comply with any of the provisions of the act or the regulations thereunder or make default in the performance or observance of any of the terms, covenants, and stipulations hereof and such default shall continue for a period of 30 days after service of written notice thereof by the lessor, the lease may be canceled by the Secretary of the Interior in accordance with section 31 of the act, as amended, and all materials, tools, machinery, appliances, structures, equipment, and wells shall thereupon become the property of the lessor, except that if said lease covers lands known to contain valuable deposits of oil or gas, the lease may be canceled only by judicial proceedings in the manner provided in section 31 of the act; but this provision shall not be construed to prevent the exercise by the lessor of any legal or equitable remedy which the lessor might otherwise have. A waiver of any particular cause of forfeiture shall not prevent the cancellation and forfeiture of this lease for any other cause of for-

(Exhibit 11-K—Continued)

feiture, or for the same cause occurring at any other time.

Sec. 8. Heirs and successors in interest.—It is further covenanted and agreed that each obligation hereunder shall extend to and be binding upon, and every benefit hereof shall inure to, the heirs, executors, administrators, successors, or assigns of the respective parties hereto.

Sec. 9. Unlawful interest.—It is also further agreed that no Member of, or Delegate to, Congress, or Resident Commissioner, after his election or appointment, or either before or after he has qualified, and during his continuance in office, and that no officer, agent, or employee of the Department of the Interior, shall be admitted to any share or part in this lease or derive any benefit that may arise therefrom; and the provisions of section 3741 of the Revised Statutes of the United States, and sections 114, 115, and 116 of the Codification of the Penal Laws of the United States approved March 4, 1909 (35 Stat. 1109), relating to contracts, enter into and form a part of this lease so far as the same may be applicable.

In Witness Whereof:

THE UNITED STATES OF
AMERICA.

By /s/ A. L. SIMPSON,

Acting Manager—Nevada
Land Survey Office.

(Exhibit 11-K—Continued)

/s/ ROBERT H. MILLER,
Lessee.

/s/ ROBT. M. BAUER,
1385 Westwood Boulevard,
Los Angeles 4, California;

/s/ DORIS M. MILLER,
1385 Westwood Boulevard,
Los Angeles 24, California;
Witnesses to Signature of
Lessee.

Form 4-216 (revised June, 1947)

Stipulation

The lands embraced in this lease (permit), issued under the mineral leasing act of February 25, 1920, (41 Stat. 437), as amended, being within a national forest, the lessee (permittee) hereby agrees:

(1) Not to cut or destroy timber without first obtaining permission from the authorized representative of the Secretary of Agriculture, and to pay for all such timber cut or destroyed at rates prescribed by such representative; to avoid unnecessary damage to improvements, timber, or other cover; unless otherwise authorized by the representative of the Secretary of Agriculture, not to drill any well within 200 feet of any building standing on the leased lands; and whenever required in writing

(Exhibit 11-K—Continued)

by the authorized representative of the Secretary of Agriculture, to fence all sump holes and other excavations made by lessee (permittee).

(2) To do all in his power to prevent and suppress forest, brush or grass fires on the leased land and in its vicinity, and to require his employees, contractors, subcontractors, and employees of contractors or subcontractors to do likewise. Unless prevented by circumstances over which he has no control, the lessee (permittee) shall place his employees, contractors, subcontractors, and employees of contractors and subcontractors employed on the leased land at the disposal of any authorized officer of the Department of Agriculture for the purpose of fighting forest, brush, or grass fires, with the understanding that payment for such services shall be made at rates to be determined by the authorized representative of the Secretary of Agriculture, which rates shall not be less than the current rates of pay prevailing in the vicinity for services of a similar character: Provided, That if the lessee (permittee), his employees, contractors, subcontractors, or employees of contractors or subcontractors, caused or could have prevented the origin or spread of the said fire or fires, no payment shall be made for services so rendered.

During periods of serious fire danger to forest, brush, or grass, as may be specified by the authorized representative of the Secretary of Agriculture, the lessee (permittee) shall prohibit smoking and the building of camp and lunch fires by his employees,

(Exhibit 11-K—Continued)

contractors, subcontractors, and employees of contractors or subcontractors within the leased area except at established camps, and shall enforce this prohibition by all means within his power: Provided, That the authorized representative of the Secretary of Agriculture may designate safe places where, after all inflammable material has been cleared away, camp fires be built for the purpose of heating lunches and where, at the option of the lessee (permittee), smoking may be permitted.

The lessee (permittee) shall not burn rubbish, trash, or other inflammable materials except with the consent of the authorized representative of the Secretary of Agriculture and shall not use explosives in such manner as to scatter inflammable materials on the surface of the land during the forest, brush, or grass fire season, except as authorized to do so or on areas approved by such representative.

The lessee (permittee) shall build or construct, such fire lines or do such clearing on the leased land as the authorized representative of the Secretary of Agriculture decides is necessary for forest, brush, and grass fire prevention and shall maintain such fire tools at his headquarters on the leased land as are deemed necessary by such representative.

(3) To pay the lessor or his tenant, as the case may be, for any and all damage to or destruction of property caused by lessee's (permittee's) operations hereunder; and to save and hold the lessor harmless

(Exhibit 11-K—Continued)

from all damage or claims for damage to persons or property resulting from the lessee's (permittee's) operations under this lease (permit).

(4) To address all matters relating to this stipulation to the Forest Supervisor of the National Forest in which the leased lands are located, or to such other representative as the Secretary of Agriculture may, from time to time, designate in writing delivered to the lessee (permittee).

(5) If lessee (permittee) shall construct any camp on the land, such camp shall be located at a place approved by the forest supervisor, and such forest supervisor shall have authority to require that such camp be kept in a neat and sanitary condition.

(6) That the lessee hereby recognizes existing commitments in the form of Forest Service grazing permits, and agrees to conduct his operations so as to interfere as little as possible with the rights and privileges granted by these permits.

/s/ ROBERT H. MILLER,
Lessee (Permittee).

(Exhibit 11-K—Continued)

Schedule "A"

Rentals and Royalties

Rentals—To pay the lessor in advance on the first day of the month in which the lease issues a rental at the following rates:

(a) If the lands are wholly outside the known geologic structure of a producing oil or gas field:

(1) For the first lease year, a rental of 50 cents per acre.

(2) For the second and third lease years, no rental.

(3) For the fourth and fifth years, 25 cents per acre.

(4) For the sixth and each succeeding year, 50 cents per acre.

(b) On leases wholly or partly within the geologic structure of a producing oil or gas field:

(1) Beginning with the first lease year after 30 days' notice that all or part of the land is included in such a structure and for each year thereafter, prior to a discovery of oil or gas on the lands herein, \$1 per acre.

(2) On the lands committed to an approved Co-operative or unit plan which includes a well capable of producing oil or gas and contains a general provision for allocation of production,

(Exhibit 11-K—Continued)

for the lands not within the participating area an annual rental of 50 cents per acre for the first and each succeeding lease year following discovery.

Minimum royalty—To pay the lessor in lieu of rental at the expiration of each lease year after discovery a minimum royalty of \$1 per acre or, if there is production, the difference between the actual royalty paid during the year and the prescribed minimum royalty of \$1 per acre, provided that on unitized leases, the minimum royalty shall be payable only on the participating acreage.

Royalty on production—To pay the lessor 12½ per cent royalty on the production removed or sold from the leased lands.

The average production per well per day for oil and for gas shall be determined pursuant to 30 CFR, Part 221, "Oil and Gas Operating Regulations."

In determining the amount or value of gas and liquid products produced, the amount or value shall be net after an allowance for the cost of manufacture. The allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior.

Filed at hearing December 14, 1953.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 45894

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

ROBERT H. MILLER and DORIS K. MILLER,
Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court
of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered November 8, 1954, pursuant to its Memorandum Findings of Fact and Opinion filed August 17, 1954, ordering and deciding "That there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$19.26 and \$122.64."

This petition for review is taken pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondents on review, Robert H. Miller and Doris K. Miller, husband and wife, are residents of Los Angeles, California, and filed joint Federal income tax returns for the calendar years 1948 and

1949, the years involved herein, with the Collector (now District Director) of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

This case involves income tax deficiencies for the years 1948 and 1949 in the respective amounts of \$983.72 and \$9,454.06.

Nature of Controversy

The question to be presented to this Court is: Whether the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code of 1939, or whether such payments are deductible as ordinary and necessary expenses under either subsection (1) or (2) of Section 23(a) of the Code?

In deciding the question adversely to the Government, the Tax Court of the United States followed and cited its prior decision in the case of *Olen F. Featherstone*, 22 T.C. . . . No. 96, filed June 30, 1954, wherein it held that the first year payments made on the non-competitive oil and gas leases issued by the United States pursuant to the authority of the Leasing Act of 1920 (41 Stat. 437) as amended August 8, 1946 (60 Stat. 950, 30 U.S.C.

181 et seq.), are true rentals and are deductible as ordinary and necessary expenses under the provisions of Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

The Commissioner presents that the so-called "rentals" were consideration paid for an oil and gas interest of indefinite duration and, therefore, they should not be deducted in full, but should be capitalized and recovered through depletion allowances.

Statement of Points to Be Relied Upon

The following Statement of Points to be relied upon are set forth as follows:

1. In holding and deciding that first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands are ordinary and necessary expenses and deductible under Section 23(a) of the Internal Revenue Code.

2. In failing to hold and decide that the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code.

3. In holding and deciding that the payments made by the taxpayers to the first lease years of the non-competitive leases were "true rentals."

4. In failing to hold and decide that the payments made by the taxpayers to the first lease year were in the nature of bonuses or advanced royalty.

5. In failing to hold and find that the payments were made for the acquisition of an economic interest in a mineral deposit within the meaning of Treasury Regulations, and represent a capital investment in the property recoverable only through the depletion allowance.

6. In that the opinion and decision are contrary to the law and the regulations, and are not supported by substantial evidence of record.

7. In ordering and deciding that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$19.26 and \$122.64.

8. In failing to order and decide that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$983.72 and \$9,454.06.

Wherefore, it is prayed that the matters complained of herein be reviewed and the errors corrected by reversing the decision of the Tax Court herein and remanding the case to the Tax Court to vacate its decision and to enter a decision in accordance with such mandate and opinion.

/s/ H. BRIAN HOLLAND, A.A.R.
Assistant Attorney General.

/s/ R. P. HERTZOG, A.A.R.
Acting Chief Counsel, Internal Revenue Service,
Counsel for Petitioner on Review.

Of Counsel:

C. R. MARSHALL,
Special Attorney, Internal
Revenue Service.

Filed January 28, 1955. T.C.U.S.

[Title of Court of Appeals and Cause.]

PROPOSED STATEMENT OF POINTS

The Commissioner submits the following Statement of Points upon which he intends to rely as the basis of the petition for review:

That The Tax Court of the United States erred:

1. In holding and deciding that first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands are ordinary and necessary expenses and deductible under Section 23(a) of the Internal Revenue Code.

2. In failing to hold and decide that the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code.

3. In holding and deciding that the payments made by the taxpayers to the first lease years of the non-competitive leases were "true rentals."

4. In failing to hold and decide that the payments by the taxpayers to the first lease year were in the nature of bonuses or advanced royalty.

5. In failing to hold and find that the payments were made for the acquisition of an economic interest in a mineral deposit within the meaning of Treasury Regulations, and represent a capital investment in the property recoverable only through the depletion allowance.

6. In that the opinion and decision are contrary to the law and the regulations, and are not supported by substantial evidence of record.

7. In ordering and deciding that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$19.26 and \$122.64.

8. In failing to order and decide that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$983.72 and \$9,454.06.

/s/ H. BRIAN HOLLAND, A.A.R.
Assistant Attorney General.

/s/ R. P. HERTZOG, A.A.R.
Acting Chief Counsel; Internal Revenue Service,
Counsel for Petitioner on Review.

Affidavit of mailing attached.

Filed April 12, 1955. T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of The United States, do hereby certify that the foregoing documents, 1 to 15, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation for Contents of Record on Review" in the proceeding before The Tax Court of The United States entitled: "Robert H. Miller and Doris K. Miller, Petitioners, vs. Commissioner of Internal Revenue, Respondent, Docket No. 45894" and in which the respondent in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of April, 1955.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 14,735. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Robert H. Miller and Doris K. Miller, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed April 22, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

No. 14735

**In the United States Court of Appeals
for the Ninth Circuit**

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ROBERT H. MILLER AND DORIS K. MILLER, RESPONDENTS

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT
OF THE UNITED STATES

BRIEF FOR THE PETITIONER

H. BRIAN HOLLAND,

Assistant Attorney General,

ELLIS N. SLACK,

ROBERT N. ANDERSON,

S. DEE HANSON,

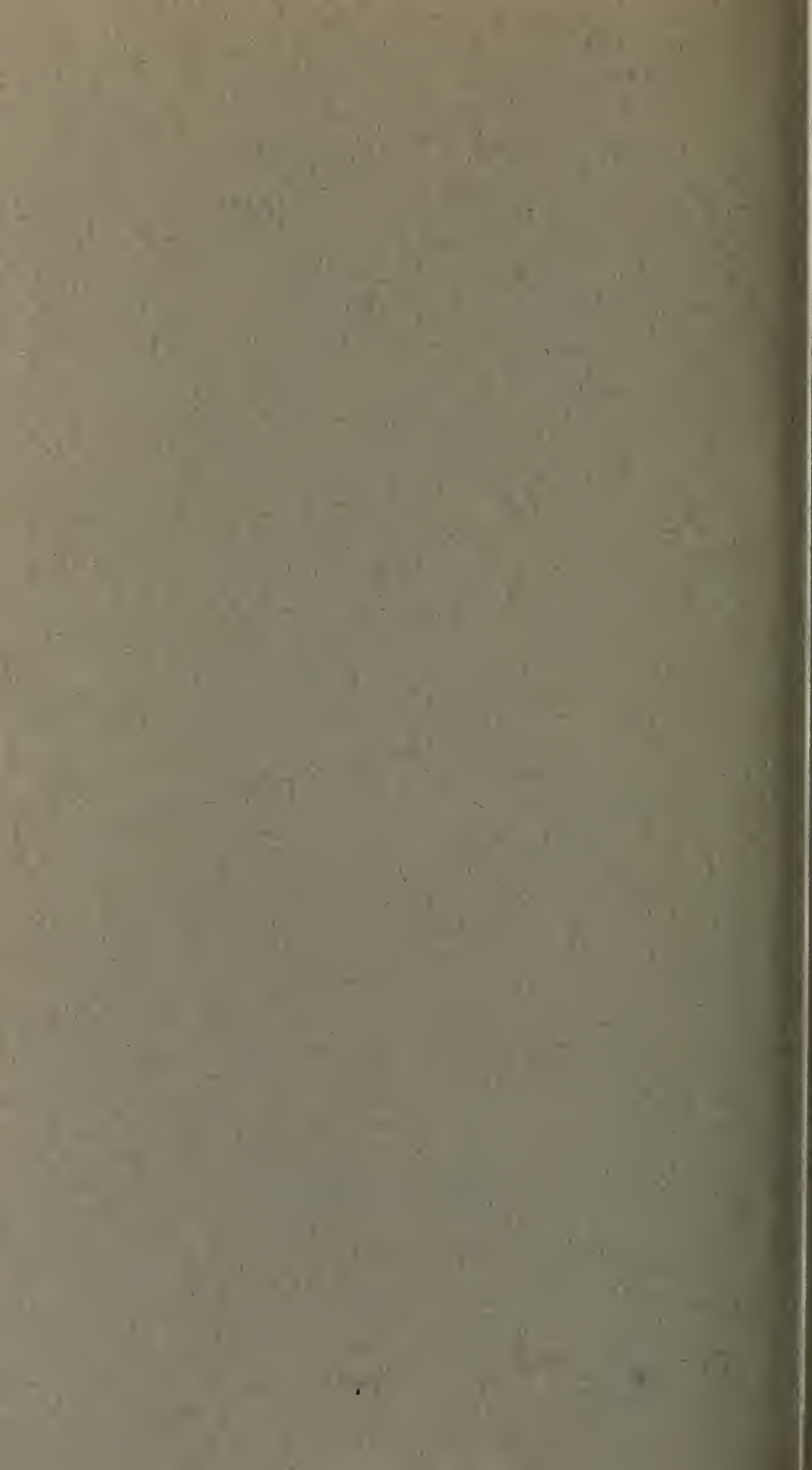
Attorneys,

Department of Justice, Washington 25, D. C.

FILED

AUG 18 1955

PAUL P. O'BRIEN, CLERK



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The so-called first-year "rentals" in question constituted in fact consideration paid for the acquisition of an economic interest of indefinite duration in the mineral deposits under the noncompetitive leases on the oil and gas lands, and therefore they represented capital investments in the properties recoverable only through depletion allowances spread over the life of the leases..

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December 12, 1952, the taxpayers filed a petition with the Tax Court for the redetermination of such deficiencies, under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 5-15.) The decision of the Tax Court redetermining and reducing in large part the deficiencies asserted by the Commissioner, as shown above, was entered on November 8, 1954. (R. 23.) The case is brought to this Court by petition for review filed by the Commissioner on January 28, 1955. (R. 55-58.) The jurisdiction of this Court is invoked pursuant to Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the first-year payments made by the taxpayer during the taxable years 1948 and 1949 for the acquisition of the non-competitive Government leases on oil and gas lands here involved constituted non-deductible capital expenditures recoverable only through depletion deductions, under the provisions of Section 23 (m) of the Internal Revenue Code of 1939, rather than ordinary and necessary business expenses deductible as statutory "rentals" under Section 23 (a) (1) (A) of the 1939 Code, as held by the Tax Court.

STATUTE AND REGULATIONS INVOLVED

These are printed in the Appendix, *infra*.

STATEMENT

The facts were stipulated (R. 24-54), and were found by the Tax Court accordingly. So far as pertinent here they are substantially as follows (R. 17-20):

The taxpayers are, and were during 1948 and 1949, husband and wife and residents of Los Angeles, California. They filed joint income tax returns, prepared on the cash receipts and disbursements basis, for the years 1948 and 1949 with the Collector for the Sixth District of California. (R. 17.)

Robert H. Miller, sometimes hereinafter referred to as the taxpayer, is a geologist and is, and has been, engaged in various enterprises in the oil and gas field. (R. 17.)

Under date of July 1, 1947, the taxpayer, I. W. Bosworth and Glenn C. Ferguson formed a partnership, with each having a one-third interest, known as I. W. Bosworth and Associates, and sometimes hereinafter referred to as the Bosworth partnership. Under date of August 1, 1948, taxpayer, I. W. Bosworth and Glenn C. Ferguson, formed another partnership, with each having a one-third interest, known as Robert H. Miller and Associates, and sometimes hereinafter referred to as the Miller partnership. Under date of May 1, 1949, taxpayer, I. W. Bosworth, Glenn C. Ferguson and J. N. Huber formed a third partnership, with each having a one-fourth interest, known as the Equity Oil Company, and sometimes hereinafter referred to as the Equity partnership. All the foregoing partnerships were formed for the purpose of acquiring oil and gas leases for investment and development. Each of the partnerships reported its income on the cash receipts and disbursements basis. (R. 18.)

During the taxable years involved herein, the above-mentioned partnerships acquired noncompetitive oil

and gas leases on United States Government lands. All of the leases were issued pursuant to the authority of the Mineral Lands Leasing Act, c. 85, 41 Stat. 437, Section 1, as amended by the Act of August 8, 1946, c. 916, 60 Stat. 950, Section 1 (30 U. S. C. 1952 ed., Sec. 181). Applications for such leases, accompanied by a filing fee of \$10, were made by the respective partnerships through their individual members, and the leases, when issued, were executed by the partnerships through their individual members, and on behalf of the United States Government by a properly authorized official. (R. 18-19.)

During its fiscal year ended January 31, 1948, the Bosworth partnership paid filing fees of \$173 in connection with applications made for noncompetitive oil and gas leases, and on noncompetitive oil and gas leases made first-year payments totaling \$8,652.22. In determining the amount of the taxpayer's distributive share of the partnership's loss for the partnership's fiscal year ended January 31, 1948, to be allowed as a deduction in his income tax return for 1948, the Commissioner determined that the fees and first year payments totaling \$8,825.22 were not allowable deductions. (R. 19.)

During its fiscal year ended January 31, 1949, the Bosworth partnership paid filing fees of \$333 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first-year payments totaling \$30,972.08, or a total of \$31,305.38. During its fiscal period ended January 31, 1949, the Miller partnership paid filing fees of \$312 in connection with ap-

plications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases, made first-year payments totaling \$5,384.50, or a total of \$5,696.50. During the period beginning May 1, 1949, and ended December 31, 1949, the Equity partnership paid filing fees of \$330 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first-year payments totaling \$20,103.44, or a total of \$20,433.44. In determining the amount of the taxpayer's distributive share of the partnership loss from the foregoing partnerships to be allowed as deductions in the taxpayers' income tax return for 1949, the Commissioner determined that such filing fees and first-year payments were not allowable deductions. (R. 19-20.)

The non-competitive oil and gas leases obtained by the various partnerships and involved herein contained the following (R. 20, 33-34):

SECTION 1. *Rights of lessee.*—That the lessor, in consideration of rents and royalties to be paid, and the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the lessee the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits except helium gas in or under the following-described tracts of land * * * together with the right to construct and maintain thereupon all works, buildings, plants, waterways, roads, telegraph or telephone lines, pipe lines, reservoirs, tanks, pumping stations, or other structures necessary to the full enjoyment thereof,

for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities * * *.

On the basis of these facts, the Tax Court, overruling the Commissioner's determination (R. 11-15) in large part, held that the first-year payments made by the taxpayer during the taxable years for the acquisition of the non-competitive Government leases on oil and gas lands were deductible as rentals, rather than non-deductible capital expenditures recoverable through depletion allowances (R. 20-22). At the same time, the Tax Court, for lack of proof to show error, sustained the Commissioner's action in determining that the filing fees paid by the taxpayer were not deductible expenses. The Tax Court thereupon entered its decision accordingly (R. 23), from which the Commissioner petitioned this Court for review (R. 55).

STATEMENT OF POINTS TO BE URGED

The Tax Court of the United States erred (R. 59-60):

1. In holding and deciding that first-year payments made by the taxpayer in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands are ordinary and necessary expenses and deductible under Section 23 (a) of the Internal Revenue Code.

2. In failing to hold and decide that the first-year payments made by the taxpayer in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capital-

ized and recovered through depletion deduction under Section 23 (m) of the Internal Revenue Code.

3. In holding and deciding that the payments made by the taxpayer in the first lease years of the non-competitive leases were "true rentals."

4. In failing to hold and decide that the payments by the taxpayer in the first lease year were in the nature of bonuses or advance royalty.

5. In failing to hold and find that the payments were made for the acquisition of an economic interest in a mineral deposit within the meaning of Treasury Regulations, and represent a capital investment in the property recoverable only through the depletion allowance.

6. In that the opinion and decision are contrary to the law and the Regulations, and are not supported by substantial evidence of record.

7. In ordering and deciding that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$19.26 and \$122.64.

8. In failing to order and decide that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$983.72 and \$9,454.06.

SUMMARY OF ARGUMENT

The expenditures for the so-called first-year "rentals" made by the taxpayer in acquiring the non-competitive Government leases on oil and gas lands were in fact consideration paid for the acquisition of an economic interest or equity of indefinite duration in the minerals in place and, therefore, in accordance

with the applicable Treasury Regulations and decisions, they could have represented nothing other than a capital investment in the mineral properties recoverable only through depletion allowances spread over the life of the leases. Although the advance payments in question are termed, variously, rents, rentals and/or royalties in the leases, this is clearly not significant for the pertinent decisions hold that these are all the same in nature and substance as advance royalties and so-called bonuses which the lessee must capitalize and recover through depletion deductions. Moreover, there is no basis whatever in the statute, Regulations or applicable decisions for the Tax Court's erroneous holding that the taxpayer's expenditures for these so-called "rentals" constituted ordinary and necessary business expense rents, within the statutory definition thereof, and deductible as such.

ARGUMENT

The so-called first-year "rentals" in question constituted in fact consideration paid for the acquisition of an economic interest of indefinite duration in the mineral deposits under the noncompetitive leases on the oil and gas lands, and therefore they represented capital investments in the properties recoverable only through depletion allowances spread over the life of the leases

The sole question presented for decision is whether the first-year so-called "rental" payments made by the taxpayer's various partnerships during the taxable years 1948 and 1949 for the acquisition of the noncompetitive Government leases on the oil and gas lands in question constituted consideration paid for

the acquisition of an economic interest of indefinite duration in the mineral deposits in place, which should properly be charged to capital and recovered through annual depletion allowances spread over the life of the leases, under the provisions of Section 23 (m) of the Internal Revenue Code of 1939 (Appendix, *infra*), as interpreted by the Regulations promulgated thereunder, rather than deducted as ordinary and necessary business expenses as held by the Tax Court.

The Tax Court, following its earlier decision in *Featherstone v. Commissioner*, 22 T. C. 763, and also the Tenth Circuit's comparatively recent decision in *United States v. Dougan*, 214 F. 2d 511, resolved the issue in favor of the taxpayers, and held that the so-called rental payments in question were not capital expenditures but constituted true "rentals" deductible as ordinary and necessary business expenses under Section 23 (a) (1) (A) of the 1939 Code (Appendix, *infra*). (R. 21.) In the *Featherstone* case involving the same type of noncompetitive Government leases as here, the Tax Court held that the first-year payments made on the oil and gas leases issued by the United States and various state governments there were likewise deductible as true rentals under Section 23 (a) (1) (A). It so concluded on the ground that the payments there in question should be considered the same in substance as "delay rentals," both purportedly being fixed sums paid to secure for the payor the right to hold the leases for the succeeding year or years without the necessity of drilling wells or making further payments, except royalties on the

minerals produced.¹ In the *Dougan* case, also involving the same kind of leases, the Tenth Circuit, affirming the District Court, had theretofore held that the first-year "rentals" there in question were not depletable capital expenditures but rather non-trade or non-business expenses paid for the production of income or for the management, conservation or maintenance of property held for the production of income, deductible only under Section 23 (a) (2) of the 1939 Code (Appendix, *infra*).² We submit that the Tax Court erred here in following its prior decision in the

¹ Delay rentals are clearly distinguishable from advance royalties and bonuses, the delay rental being a penalty imposed on the lessee by the lease for failure to drill during the current year (*Jefferson Lake Sulphur Co. v. Lambert* (E. D. La.), decided June 29, 1955 (1955 P-H, par. 72,863), as shown hereinafter. Delay rentals, however, are not involved in the present case.

² In *Dougan v. United States* (Utah), decided August 8, 1953 (without opinion), the District Court made findings of fact and conclusions of law (unreported, but may be found in 1953 P-H, par. 72,732) holding that the rentals there in question were not capital expenditures but were deductible as ordinary and necessary business expenses, within the meaning of Section 23 (a) (1) (A), and also as non-trade or non-business expenses paid for the production or collection of income, or for the conservation or maintenance of property held for the production of income, under Section 23 (a) (2); to the same effect is *Hagood v. United States* (Wyo.), decided October 26, 1953 (1953 P-H, par. 72,760), where the District Court tentatively followed the Utah District Court's earlier decision in the *Dougan* case, anticipatory to the Tenth Circuit's finally resolving the issue in both cases. Upon the Tenth Circuit's finally resolving the issue against the Government in the *Dougan* case, no appeal was presented by the Government in either the *Hagood* or the *Featherstone* cases, *supra*—both of which would have gone to that Circuit upon appeal—nor was certiorari to the Tenth Circuit petitioned for by the Government in the *Dougan* case because of the absence of a conflict.

Featherstone case, as well as the Tenth Circuit's decision in the *Dougan* case, both of which we consider to be contrary to the provisions of the pertinent statute, Regulations and decisions cited hereinafter.

The taxpayer contended in the Tax Court that the first-year payments in question were deductible as business expense rentals under Section 23 (a) (1) (A) (R. 21)—that is, in the language of the statute, “rentals * * * required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity,” and as such they were deductible as ordinary rent. It is our position that the amounts of the so-called “rentals” paid during the taxable years involved by the taxpayer's several partnerships in connection with the Government's issuance and their acquisition of the noncompetitive leases on the oil and gas lands were in fact, regardless of the terminology used in describing them in the leases, nothing more or less than “payment made for the acquisition of an economic interest in a mineral deposit * * * [which] constitutes a capital investment in the property recoverable only through the depletion allowance” spread over the life of the leases and deductible for the respective taxable years to which applicable, within the meaning of the statute and interpretive Regulations. Sections 23 (m) of the 1939 Code, as interpreted by Sections 29.23 (m)-1 and 29.23 (m)-10 (a) of Treasury Regulations 111 (all Appendix, *infra*).

First, it is settled that it is the nature and substance of the transaction—not the form as designated and used by the parties—which determines tax incidence, the formal attributes of the taxpayer's lease instruments and the descriptive terminology which may be applied thereto under local law both being irrelevant. *Palmer v. Bender*, 287 U. S. 551, 555; *United States v. Dougan*, *supra* (p. 513). In *Southwestern Hotel Co. v. United States*, 115 F. 2d 686, the Fifth Circuit holding that certain payments made under a lease must be capitalized, stated (p. 688):

The fact that these payments were called “additional rentals” in the lease contract can avail appellant nothing. The character of such payments must be determined in the light of the facts and circumstances surrounding them, and the *character, not the name, must control*. To hold otherwise would defeat the purpose of the act. If the name controlled the fact, this tax could be avoided by the ignorant by chance misnomer, or by the learned by intentional misnomer. [Italics supplied.]

Hence, it is clear that the fact that the payments here in question were called “rentals” in the taxpayer's leases, instead of advance royalties or bonuses, does not in any way affect their treatment for tax purposes. It is equally clear that the term rentals was used in the leases to distinguish such payments from royalties conditioned upon actual production of oil and gas. Payments made prior to production, although in the nature of royalties and considered as royalties for depletion purposes, are referred to, variously, as bonuses, advance royalties or rentals. It is

clear that this distinction has been recognized throughout the Government leases here involved by the use of the term "rents" and "rentals" versus "royalties" to differentiate the payments made or to be made before and after discovery, respectively. (R. 20, 33-34, 36, 39, 45, 53-54.) Hence, it is also clear that there is no real basis in this record for the taxpayer's contention below and the Tax Court's holding that the term "rentals", as technically used in the leases here, nevertheless comes within the statutory definition of ordinary business expense "rentals" as used in and made deductible under Section 23 (a) (1) (A). *Jefferson Lake Sulphur Co. v. Lambert* (E. D. La.), decided June 29, 1955 (1955 P-H, par. 72,863).

Apropos of the foregoing, the Tenth Circuit aptly stated it in the *Dougan* case, *supra* (p. 513), involving like leases and payments, as follows:

If the payments in question are in fact consideration for the cost of the leases to the lessees, they undoubtedly represent the cost of an economic interest in minerals and are therefore depletable capital expenditures. *Sunray Oil Co. v. Commissioner*, 10 Cir., 1945, 147 F. 2d 962; *Canadian River Gas Co., v. Higgins*, 2 Cir., 1945, 151 F. 2d 954. And this is so even though such payments would be ordinary income to a private lessor, *Burnet v. Harmel*, 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199; *Sunray Oil Co. v. Commissioner*, *supra*; *Canadian River Gas Co. v. Higgins*, *supra*; or regardless of nomenclature, *Sneed v. Commissioner*, 33 B. T. A. 478; *Kleberg v. Commissioner*, 43 B. T. A. 277; *McFaddin v. Commissioner*, 2 T. C. 395; or local legal characterizations. *Burnet v. Harmel*,

supra; *Palmer v. Bender*, 287 U. S. 551, 53 S. Ct. 225, 77 L. Ed. 512; *Houston Farms Development Co. v. United States*, 5 Cir., 1942, 131 F. 2d 577. It is the nature and substance of the transaction which determines tax incidence, *Palmer v. Bender, supra*.

Under the rules enunciated there and the decisions cited hereinafter we think it well nigh irrefragable that the terms of the leases here clearly show, contrary to the holdings of the Tax Court in the present and the *Featherstone* cases as well as those of the Tenth Circuit in the *Dougan* case, that the controverted payments made by the taxpayer's partnerships in connection with the *acquisition* of the leases plainly constituted consideration paid as part of the cost of the leases, that is, the cost of an economic interest or equity in the oil and gas deposits in place, and that as such they must be capitalized and therefore are recoverable only through annual depletion allowances spread over the life of the leases. Sections 29.23 (m)-1 and 29.23 (m)-10 (a) of Treasury Regulations 111.

Section 1 of the leases here granted to the taxpayer and his co-partner-lessees "the exclusive right and privilege" to drill for, extract and dispose of "all the oil and gas deposits * * * in or under the * * * tracts of land" leased, together with other named rights "necessary to the full enjoyment thereof, for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities * * *", all of which was "in consideration of rents and royalties to be paid" therefor (R. 20, 33-34, 36), under the

“Rentals and Royalties” schedule attached to the lease (R. 53-54). Further, Section 3 (b) of the leases gave the lessees the right to use whatever surface of any of the lands which might be necessary for their purposes, and reserved to the lessor certain rights including, among other things (R. 43):

The right to lease, sell, or otherwise dispose of the surface of any of the lands embraced within this lease * * * insofar as said surface is not necessary for the use of the lessee in the extraction and removal of the oil and gas therein.

Upon the issuance of the leases, the lessees acquired all oil and gas rights to the properties for three succeeding years without further payments of “rentals” (R. 53-54), at the end of which time they could abandon the leases without incurring any additional liability (R. 45-46). Further, the leases provided for a minimum royalty of \$1 per acre in lieu of subsequent “rentals” for later years but not in lieu of the initial “rental” payments since this former provision applied only to “each lease year after discovery”, and once the leases were issued these initial payments could not be recovered by the lessees regardless of discovery or production. (R. 53-54.) Moreover, the lessees had certain contingent rights in and to the leased oil and gas lands which they could sublet by the “Assignment of [their] oil and gas lease or interest therein”, upon approval of their 90-day notice thereof by the Government, upon the “final execution [of] any instrument of transfer made of this lease, or any interest therein, including assignments of

record title, working or royalties interests, operating agreements and subleases * * *.” (R. 40-41.)³

In the light of these facts, it is clear, we submit, that the payments in question were, contrary to the Tax Court’s holding, not true statutory rentals as defined in Section 23 (a) (1) (A), or otherwise. *Jefferson Lake Sulphur Co. v. Lambert, supra*. Rather they were in fact depletable capital expenditures paid as consideration for the cost of the leases which, under the pertinent statutes, Regulations and decisions, represented the cost of an economic interest or equity in oil and gas in place, recoverable only through depletion allowances. This is obvious for the reason that they were made solely “for the privilege of exploiting the land for the production of oil and gas for a prescribed period”—here for 5 years, or even longer in the event such minerals were produced in paying quantities. (R. 20, 33-34.) *Burnet v. Harmel*, 287 U. S. 103, 107; *Palmer v. Bender*, 287 U. S. 551, 557; *Canadian River Gas Co. v. Higgins*, 151 F. 2d 954, 956-957 (C. A. 2d), certiorari denied, 327 U. S. 793; *Sunray Oil Co. v. Commissioner*, 147 F. 2d 962, 965 (C. A. 10th); *Baton Coal Co. v. Commissioner*, 51 F. 2d 469 (C. A. 3d); *Jefferson Lake Sulphur Co. v. Lambert, supra*; Sections 23 (m) and 114 (b) (3) of the 1939 Code (Appendix, *infra*), as interpreted by Sections 29.23 (m)-1 and 29.23 (m)-10

³ It should be noted that in *Hagood v. United States* (Wyo.), decided October 26, 1953 (1953 P-H, par. 72,760), another lessee of Government oil and gas lands made it a practice, after filing applications, to negotiate with oil operators, drillers or companies, and enter into subleases and other subleasing arrangements.

(a) of Treasury Regulations 111. As noted above, Section 23 (a) (1) (A) specifically excludes from the statutory definition of "rentals" payments made with respect to property to which the taxpayer has taken or is taking title or in which he has an equity.

In this connection, it will also be noted that Section 29.23 (m)-10 (a), of the Regulations referred to above, specifically provides, in respect of "a bonus in addition to royalties * * * received upon the grant of rights in mineral property," that the payee-lessor shall be entitled to specified depletion allowances, and that—

In the case of the payor [lessee] any payment made for the acquisition of an economic interest in a mineral deposit * * * constitutes a capital investment in the property recoverable only through the depletion allowance.

Likewise, Section 29.23 (m)-1 thereof provides that—

the owner of an economic interest in mineral deposits * * * is allowed annual depletion deductions. * * * An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place * * * and [upon discovery] secures, by any form of legal relationship, income derived from the severance and sale of the mineral * * *, to which he must look for a return of his capital. * * *

These are reasonable Regulations, clearly not inconsistent with the terms of the statute, and therefore should be given the force and effect of law. *Lykes v. United States*, 343 U. S. 118, 126-127, rehearing

denied, 343 U. S. 937; *Commissioner v. South Texas Co.*, 333 U. S. 496, 501; *Morgan v. Commisisoner*, 309 U. S. 78, 81; *Morrissey v. Commissioner*, 296 U. S. 344, 355. Paraphrasing this Court's holding long ago in connection with a comparable situation involving statutory construction in *Crocker v. Lucas*, 37 F. 2d 275, 277 (1930), the construction thus placed upon the statute by the Treasury Department which is clearly not in conflict with any express provision thereof, has impliedly been recognized by the re-enactment of the revenue laws without substantial alteration in the particulars as construed, with nothing in later amendments and/or revisions militating against the construction adopted by the department, and is not plainly erroneous and has been long acquiesced in by the public, should not be overturned or departed from at this late date.

The foregoing Regulations—providing that “any” payment made by the lessee for the acquisition of an economic interest in mineral deposits in place constitutes a capital investment in the property recoverable only through depletion allowances (Treasury Regulations 111, Section 29.23 (m)–10 (a)), and that an economic interest is *possessed* in every case in which the lessee has acquired, by investment, “any” interest in mineral deposits (*id.*, Section 29.23 (m)–1)—are in harmony with and supported by the authoritative decisions. Thus, in *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25, where the transfer of rights to the taxpayer-grantee-operator under the oil contract was held to have constituted an assignment to the taxpayer of the right to exploit the prop-

erty with a reservation in the assignor of an economic interest in the oil, the Supreme Court stated (pp. 34-35, 37):

It is the lessor's, lessee's or transferee's "possibility of profit" from the use of his rights over production, "dependent solely upon the extraction and sale of the oil," which marks an economic interest in the oil. See Kirby Petroleum Co. v. Commissioner [326 U. S. 599], supra, page 604. [Italics supplied.]

* * * * *

It [the assignor's assignment] is rather an assignment to the operator, petitioner [grantee] here, of the right to exploit the property with a reservation in the assignor of an economic interest in the oil.

In *Canadian River Gas Co. v. Higgins*, 151 F. 2d 954, the Second Circuit held (p. 956) that advance royalties or so-called bonuses—"similar to rentals * * * which the lessee must capitalize"—paid by the lessees upon the execution of the leases were not deductible currently as expenses but were capital expenditures to be recovered only through depletion allowances. The court stated (pp. 956-957):

What the lessor gets *for* the lease and how that should be taxed does not control decision as to the character of what the lessee gets *under* the lease. *Just as advance royalties may be consideration for a lease and also ordinary income to the lessor, Burnet v. Harmel, supra, they may be capital investments by a lessee when paid for capital assets. They are analogous to rentals that are taxable as income to a*

landlord though *they may be bonuses or advances which the lessee must capitalize*. *Baton Coal Co. v. Commissioner*, 3 Cir., 51 F. 2d 469. So it does not follow, as the plaintiff argues, that because the advance royalties are taxable as ordinary income to the lessors *the lessee did* not make a capital investment when it paid them in consideration for the leases. In *Helvering v. Bankline Oil Co.* [303 U. S. 362], *supra*, the taxpayer had but a contract right to process certain wet gas at the casingheads and was held to have no depletable interest but only an economic advantage not an asset subject to an allowance for depletion. By way of contrast it should be noticed that the present plaintiff acquired the right to exploit the property by drilling wells and operating them to produce whatever it could from the gas in the ground. *The cost of those leases, i. e., the advance royalties, was part of the capital it had to invest before production started, was the consideration paid for an economic interest in the gas bearing land leased. It thereby obtained an asset which was depletable* not because of the existence of the arbitrary depletion method of Sec. 114 (b) (3) but *because it was a wasting capital asset which was inherently depletable. The advance royalties instead of being paid as a part of the purchase price of gas bought for resale were paid as the consideration for the conveyance of a leasehold in which the plaintiff invested to obtain the right to produce gas from the land leased. Cf. Burton-Sutton Oil Co. v. Commissioner*, 5 Cir., 150 F. 2d 621. It would be plain enough that these payments would have been capital ex-

penditures had they been made for the fee. They were, we think, none the less so because only a leasehold was obtained. [Italics supplied.]

Likewise, in *Sunray Oil Co. v. Commissioner*, 147 F. 2d 962, the Tenth Circuit held (p. 966) that bonuses or advance royalties paid by the taxpayers to the State of Oklahoma for oil and gas leases represented cost to the lessees and were capital expenditures to be recovered through depletion. The court pointed out that to allow these payments as current deductions from gross income would be, in effect, to allow double deductions, that is, cost depletion in addition to percentage depletion, by reason of the fact that had the taxpayers elected to take cost depletion, the bonuses or advance royalties would have been included in the base for cost depletion. The court there stated (p. 966):

While advance royalties are regarded as income to the lessor, with respect to the lessee, they represent cost and are a capital expenditure.¹⁴ *There is no incongruity in the view that a bonus and royalty are "consideration for the lease, and are income of the lessor."* *Burnet v. Harmel, supra*, 287 U. S. 103 at page 112, 53 S. Ct. at page 77, 77 L. Ed. 199. Not infrequently, payments made for an article constitute a capital investment by the payor, but income to the recipient. Where a manufacturer processes raw materials and constructs therefrom a finished product, and sells such product, the whole of the purchase price may be a capital investment by the purchaser, but, to the extent

it exceeds the cost of goods sold, it is gross income to the manufacturer.¹⁵ It is significant that in the accounting practices of 30 of the 32 principal companies engaged in the production of oil, *an advance royalty* is treated from the payor's standpoint as a capital investment.¹⁶ [Italics supplied.]

¹⁴ *Baton Coal Co. v. Commissioner of Internal Revenue*, 3 Cir., 51 F. 2d 469, 470; Law of Federal Income Taxation, Mertens, Vol. 2, Sec. 12:31; Id., Vol. 4, Sec. 25.22.

¹⁵ See *United States v. Ludey*, 274 U. S. 295, 302, 47 S. Ct. 608, 71 L. Ed. 1054; Art. 22 (a)-5, Tr. Reg. 101.

¹⁶ Depletion in the Oil Industry, Paul Forasté (1943), p. 9.

Also, in the recent case of *Jefferson Lake Sulphur Co. v. Lambert* (E. D. La.), decided June 29, 1955 (1955 P-H, par. 72, 863), the District Court, holding that the taxpayer-lessee's quarterly payments made during the primary term of the sulphur lease there were not deductible as statutory "rentals" under Section 23 (a) (1) (A) as claimed by the taxpayer, stated:

The quarterly payments in suit were not delay rentals since they were to be paid irrespective of production from the property. * * * unquestionably, the taxpayer here, when he acquired the right to go on the property and mine sulphur, obtained an economic interest or equity in the minerals in place in that land. *Burton-Sutton Oil Co. v. Commissioner*, *supra*, p. 34-35. Consequently, the quarterly payments do not come under the statutory definition of rent and are not, therefore, deductible as such.

Apropos of the foregoing "economic interest" test as set forth in the above-mentioned Regulations and decisions, this Court in *Commissioner v. Southwest Exploration Co.*, 220 F. 2d 58, affirming the decision of the Tax Court (18 T. C. 961), and holding that the taxpayer, which had paid over to the upland owners for easements-to-drill sites 24½% of its net profits, nevertheless owned the entire capital interest in the oil deposits there involved under its agreement with the State of California, and therefore was entitled to the depletion deductions for the extracted off-shore oil,⁴ stated as follows (pp. 60-61, 62):

* * * the depletion deduction is allowable only to those who have a capital investment or economic interest in the oil or other mineral in place from which income is received by reason thereof. *Kirby Petroleum Company v. Commissioner*, 326 U. S. 599 * * *; *Burton-Sutton Oil Co., Inc. v. Commissioner*, 328 U. S. 25 * * *; *Helvering v. Bankline Oil Company*, *supra* [303 U. S. 362]; *United States v. Spalding* (9 Cir.), 97 F. 2d 701. In determining whether a taxpayer has such an investment or interest no significance attaches to the particular legal form of the transaction creating the rights. *Burton-Sutton Oil Co., Inc. v. Commissioner*, *supra*; *Palmer v. Bender*, 287 U. S. 551 * * *; *Lynch v. Alsworth-Stephens Co.*, 267

⁴ The Court of Claims held in *Huntington Beach Co. v. United States*, decided July 12, 1955 (1955 P-H, par. 72, 835), however, that the depletion was allowable to the adjoining land owners on the profit payments from the off-shore oil production. Both cases are now pending in the Supreme Court on the Government's petitions for certiorari filed August 2, 1955.

U. S. 364 * * *. It is enough that the taxpayer has acquired through any form of legal relationship the right to share in the oil produced. *Palmer v. Bender, supra*. And a right to share in the profits from the sale of the oil following extraction is analogous to a right to share in the mineral itself. *Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312 * * *; *Anderson v. Helvering, supra* [310 U. S. 404]; *Kirby Petroleum Company v. Commissioner, supra*; *Burton-Sutton Oil Co., Inc. v. Commissioner, supra*. * * *

* * * * *

* * * in so far as the 835 acres here involved are concerned, any present economic interests therein were acquired by virtue of, and simultaneously with the Agreement for State Easement No. 392 or through some transaction subsequent thereto.

The State and petitioner were the only parties to the body of this agreement. The granting clause therein granted to the petitioner the sole and “* * * exclusive right to drain, take, receive, extract, remove, and produce from the * * * lands, oil, gas, and other hydrocarbon substances * * *.” This right is not made subject to any pre-existing rights and there is no provision therein for income derived from oil production to be shared with third parties. Within its four corners, then, it would appear that such economic interests as were passed therein, were acquired by petitioner alone. * * *

In summation, then, it is our view that petitioner was the sole recipient under the Agreement for State Easement No. 392 of an economic interest in the oil property involved; * * *

While the issue involved in that case is not involved here, nevertheless the rules in respect of the economic interest in the oil in place acquired by the taxpayer in its agreement with the State of California, as laid down by this Court there, are equally applicable here in respect of the taxpayer's acquisition of an economic interest in the oil and gas in place under his agreements (non-competitive leases) with the United States.

In harmony with the foregoing, the Tax Court itself, contrary to its holding here (R. 21) and in the *Featherstone* case (p. 771), has held in a series of cases that annual "rentals" and analogous payments made for leases on oil, gas, ore, etc., lands constituted payments made in consideration of an economic interest in minerals in place. See *McFaddin v. Commissioner*, 2 T. C. 395, 404-405, affirmed in part and remanded without discussion on this point, 148 F. 2d 570 (C. A. 5th), holding that "Royalties and bonuses under oil, gas, and mineral leases have some resemblance to rentals," and that annual payments called "rentals," due and payable in advance were "in the nature of advance royalties" or "guaranteed minimum royalties", in accord with its previous holding in *Kleberg v. Commissioner*, 43 B. T. A. 277, where it was held (pp. 289-294) that the lessee's payments on the oil and gas lands leased for production there constituted a bonus in the nature of advance royalties, notwithstanding that the amount, paid in two installments, was calculated on the basis of certain annual payments for 20 years discounted at their present value; *Westates Petroleum Co. v. Commissioner*, 21 T. C. 35, 39, holding, on the authority of

Sunray Oil Co. v. Commissioner, supra, that “A cash bonus payment paid as consideration for such a lease [for the right, for one year, to enter into and explore and drill for oil and gas on the leased property] is regarded as advance royalties * * * and must similarly be classified as a bonus paid to obtain the option” therefor; *Kittle v. Commissioner*, 21 T. C. 79, 88, holding that the advance payments there required of the lessee under the lease of iron ore lands were identical in character with and therefore represented advance royalties or cash bonus payments, as in *Burnet v. Harmel*, 287 U. S. 103, and *Bankers Coal Co. v. Burnet*, 287 U. S. 308; *Patch v. Commissioner*, decided December 13, 1941 (1941 P-H B. T. A. Memorandum Decisions, par. 41,552), holding that the annual rental there which was to be received by the lessor regardless of drilling or production constituted an advance royalty.

Nor is there any basis in the statute, Regulations or decisions for the Tax Court's holding here, as in the *Featherstone* case (p. 771), that only “rentals” paid in respect of a year in which minerals were produced in paying quantities constitute capital expenditures recoverable through depletion deductions (R. 21). It is settled, as pointed out, that advance royalties or so-called bonuses—essentially “analogous to rentals * * * which the lessee must capitalize” (*Canadian River Gas Co. v. Higgins, supra*, p. 956)—represent capital payments paid in advance upon the execution of leases for oil and gas *to be extracted*, even though there was no production when the leases were made or at any time within the taxable year, and

that the depletion deduction is not based exclusively upon the actual production of minerals in that year. *Herring v. Commissioner*, 293 U. S. 222; *Burton-Sutton Oil Co. v. Commissioner*, *supra* (pp. 34-35, 37); *Burnet v. Harmel*, *supra* (p. 107). While the lessor may take percentage depletion deductions on bonuses and advance royalties when received, and the lessee must capitalize such payments (Treasury Regulations 111, Sec. 29.23 (m)-10 (a)), yet if the lease later proves unproductive, the lessor must restore such previous deductions to the income of the year of abandonment of the property (*id.*, Sec. 29.23 (m)-10 (c), Appendix, *infra*; *Douglas v. Commissioner*, 134 F. 2d 762 (C. A. 8th)), and the lessee is entitled to deduction of the full amount of the payments made on the lease as an abandonment loss at the time of the termination or abandonment of the lease. On the other hand, if the lease turns out to be productive, the advance payments, initially capitalized, are recoverable through depletion allowances to the lessee. Hence, the taxpayer-lessee here is not entitled to deductions of the first-year "rentals" payments as business expense under Section 23 (a) (1) (A) for that would amount to a double deduction which is not permissible under any circumstances. *Id.*, Sec. 29.23 (a)-1, Appendix, *infra*; *Sunray Oil Co. v. Commissioner*, *supra* (pp. 966-967); *Canadian River Gas Co. v. Higgins*, *supra* (p. 956); *Jefferson Lake Sulphur Co. v. Lambert*, *supra*.

In these circumstances, it is difficult to perceive how anyone, in the light of the above-cited controlling decisions, could properly say that advance payments

such as the taxpayer's so-called rentals could possibly have represented anything other than capital investment recoverable through annual depletion deductions spread over the life of the oil and gas leases. Yet the Tenth Circuit did so in its adverse decision in *United States v. Dougan*, *supra* (p. 514), despite its own previous decision in the *Sunray Oil Co.* case, *supra* (p. 966) holding to the contrary. In the *Sunray* case, it had held, as pointed out, that advance royalties and bonuses paid by the lessee represented cost and were capital expenditures because they were consideration for the lease and therefore were properly treated from the payor's standpoint as capital investment. As against this, the court nevertheless held in respect of the first-year advance rentals in the *Dougan* case (p. 514) that—

A consideration of the applicable statutes, regulations and leases issued in conformity therewith leads us to the conclusion that Congress intended to draw a clear distinction between bonuses and advance royalties paid as a consideration for competitive leases and first-year rentals on non-competitive leases granted to the first qualified applicant on payment of the prescribed filing fee. With respect to the latter leases, we think Congress intended a free-grant lease in consideration for the prescribed filing fee, conditioned upon the payment of the first-year and subsequent stipulated rentals until after discovery. After discovery upon the leased lands the lessee becomes obligated to pay a minimum royalty in lieu of rentals.

We are unable to find any *real* basis or authority—and, it will be noted, the Tenth Circuit furnished none—for the court's purported distinction, said by it to have been intended by Congress,⁵ between advance royalties, bonuses and so-called rentals *paid as consideration for competitive* leases on the one hand and *non-competitive* leases on the other, other than the manner and legal procedure by which they are acquired. In either event, the payments made in connection with the acquisition of the leases constitutes part of the purchase price. Moreover, the attempted distinction flies directly in the teeth of the rule laid down by the Supreme Court in the *Burton-Sutton Oil Co.* case, *supra* (pp. 34-35, 37), and other related cases above-cited, namely, that it is the lessee's *possibility of profit* from the use of his right to exploit the property under the lease which marks his economic interest or equity in the minerals in place. It is also directly contrary to the specific provisions of the above-cited Regulations (Secs. 29.23 (m)-10 (a) and 29.23 (m)-1 of Treasury Regulations 111) providing that "any" payment—advance royalty, bonus, so-called rentals, etc., by whatever name called—made by the lessee for the *acquisition of* an economic interest in mineral deposits constitutes a capital investment in the property recoverable only through the depletion allowance. Hence, insofar as

⁵ As the Fifth Circuit aptly held in *Commissioner v. Gracey*, 159 F. 2d 324, 325, "we may not speculate as to what Congress might have contemplated or intended. We must construe and apply the law as it is written", citing *Sabine Transp. Co. v. Commissioner*, 128 F. 2d 945, (C. A. 5th), affirmed 318 U. S. 306, and *Helvering v. Credit Alliance Corp.*, 316 U. S. 107.

the statute, Regulations and applicable decisions disclose, there is no conceivable, or indeed possible, difference between the essential nature and character of advance royalties, bonuses and/or so-called rentals paid by the lessee in connection with the acquisition of and as consideration for competitive versus non-competitive leases embracing minerals in place. Unaccountably, moreover, the Tenth Circuit gave support to this conclusion by holding in the *Dougan* case (p. 514) that "Surely the [non-competitive] leases were property rights in which the lessees were taking title or in which they held some equity", which is in harmony with the above-cited statute, Regulations and controlling decisions.

At that point, however, the Tenth Circuit, in the *Dougan* case, veered off in another direction whereby it arrived at its adverse conclusion (p. 515) transmuting nondeductible capital items, the so-called first year rentals there, into non-business expense items deductible not under Section 23 (a) (1) (A) but only under subsection (a) (2) thereof as ordinary and necessary expenses paid or incurred during the taxable years for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income. In so holding the court said (p. 514) that it could find no warrant for the District Court's conclusion in the *Dougan* case that the first-year rental payments there were made as a condition for the continued use or possession of property, title to which the taxpayers had not taken or were not taking or in which they had no equity. Thus the court thereby nega-

tived the District Court's holding that the rentals in question were also deductible as ordinary and necessary business expenses under Section 23 (a) (1) (A). This, in turn, operates as judicial authority against the Tax Court's holdings of the deductibility of analogous "rentals" under that section here and in the *Featherstone* case.

The District Court, holding in *Jefferson Lake Sulphur Co. v. Lambert, supra*, that the taxpayer-lessee's quarterly payments there were not deductible under Section 23 (a) (1) (A) because they did not come within the statutory definition of "rentals" therein, stated further that the *Dougan* and *Featherstone* cases, in the light of the decision in *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25, were not persuasive in holding that the first-year "rentals" under the leases there were deductible instead of chargeable to capital investment—as above indicated. The reason assigned therefor by the District Court was as previously pointed out, that "unquestionably", under the rule laid down by the Supreme Court in the *Burton-Sutton Oil Co.* case, *supra* (pp. 34-35) the taxpayer in the *Jefferson Lake Sulphur* case, upon acquiring the right to go on the property and mine sulphur, thereby obtained a real economic interest or equity in the minerals in place in that land, and therefore the lessee's quarterly payments were not, contrary to the holdings of the Tax Court here and in the *Featherstone* case, deductible as business expense "rentals" under Section 23 (a) (1) (A). But the District Court thereupon likewise swerved

off in another direction and held, purportedly on the authority of the *Burton-Sutton Oil Co.* case, *supra*,⁶ that since, under the authorities, the quarterly payments there were depletable as advance royalties by the lessor, they were in turn excludible from income as advance royalties by the lessee. It so held despite the fact that this result left no adequate capital basis to support statutory depletion allowances on the proceeds from the minerals produced from the leasehold which the taxpayer had been claiming for many years. This, however, it held, was a matter which was not the concern of the court or the Commissioner in the purported absence of "the need in law for such basis [which] does not clearly exist." In so deciding the case, the District Court declined to follow the Second, Third, Fifth and Tenth Circuits' decisions in *Canadian River Gas Co. v. Higgins*, *supra*, *Baton Coal Co. v. Commissioner*, 51 F. 2d 469; *Quintana Petroleum Co. v. Commissioner*, 143 F. 2d 588,⁷ and *Sunray Oil Co. v. Commissioner*, *supra*,⁸ respec-

⁶ The District Court conceded that the grantee-operator's payments to the owner-lessor in the *Burton-Sutton Oil Co.* case were not characterized as and in fact were materially different from bonuses and advance royalties, and therefore that "that case may be distinguishable * * * on its facts." Nevertheless, it stated that "the principle there applied is applicable here" and thereupon found and applied a newly-devised principle of its own without statutory basis therefor, as shown hereinafter.

⁷ The District Court stated in the *Jefferson Lake Sulphur Co.* case (fn. 10) that while the Fifth Circuit "seems" to have held in the *Quintana* case that advance royalties are not excludible from income by the lessee, yet it later "apparently" admitted in *Commissioner v. Gracey*, 159 F. 2d 324, that its decision in the *Quintana* case was contrary to the principles approved by the Supreme

tively, on the ground that those cases, ostensibly, were inconsistent with the principles enunciated by the Supreme Court in certain specified decisions, particularly *Burton-Sutton Oil Co. v. Commissioner, supra*. In the light of what has been said before, however, it is clear that the District Court erred in allowing the taxpayer-lessee deductions for the quarterly payments there in question as advance royalties excludible from income, in the absence of any stated or existing provision in the statute providing therefor, and that its decision in this respect is otherwise directly contrary to the specific provisions of the statute and applicable Regulations as well as the *controlling* decisions heretofore cited.

In these circumstances, it follows, we submit, that since the controverted "rental" payments here unquestionably constituted capital expenditures recoverable only through depletion allowances spread over the life of taxpayer's leases, they may not properly be treated as ordinary and necessary business expenses deductible under Section 23 (a) (1) (A), as erroneously held by the Tax Court.

Court in the *Burton-Sutton Oil Co.* case. A reading of the *Gracey* decision shows that the Fifth Circuit reversed and remanded that case to the Tax Court for a redetermination of the issue—whether the share of the taxpayer's profits paid under the oil lease assignment, adjusted for depletion, was deductible—in accordance with the Supreme Court's decision in the *Burton-Sutton* case. It fails to disclose, however, that the Fifth Circuit there conceded, directly or indirectly, that its decision under the facts of the *Quintana* case was contrary to the rule of the *Burton-Sutton* case, nor did it even mention the *Quintana* case therein.

Nor, in any event, alternatively, is there anything in the record showing that the first-year payments in question were paid or incurred by the taxpayer in carrying on any trade or business during the taxable years involved. Neither does the record disclose that he was carrying on any trade or business incident to oil and gas leases, or that he was engaged in any pursuit or occupation to which he contributed the major or a substantial part of his time for the purpose of a livelihood or profit during the taxable years in which these payments were made, as required by the statute in order to be deductible. *Snyder v. Commissioner*, 295 U. S. 134; *Higgins v. Commissioner*, 312 U. S. 212. At best, in so far as the record shows, the taxpayer, together with his partners, was engaged solely in a series of a few isolated transactions whereby he made investments in oil and gas leases but this, needless to say, did not constitute carrying on a trade or business within the rule of the *Higgins* case, *supra*. Hence, even *assuming* that the payments in question were ordinary statutory "rentals" within the definition thereof in Section 23 (a) (1) (A), as the Tax Court held, nevertheless, contrary to its holding, the provisions of that section are clearly not applicable here, as shown immediately above, and as the Tenth Circuit held in respect of like first-year rentals in the *Dougan* case (pp. 514-515).

In view of the foregoing, we submit that the taxpayer's first-year "rental" payments here in question clearly were not ordinary and necessary business expenses deductible under Section 23 (a) (1) (A), but

solely part of the purchase price of the leases paid as consideration for the acquisition of an economic interest or equity in the mineral deposits in place under the several leases during the taxable years involved, and therefore capital expenditures, within the meaning of the pertinent statutes, Regulations and controlling decisions heretofore cited. Consequently, it is clear that the Tax Court erred in holding that the disputed payments were ordinary and necessary business expenses deductible as true "rentals" under Section 23 (a) (1) (A) of the 1939 Code.

CONCLUSION

The decision of the Tax Court is erroneous in that it is directly contrary to the terms of the applicable statute, Regulations and controlling decisions, and therefore it should be reversed and judgment entered for the Commissioner upon review by this Court.

Respectfully submitted.

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AUGUST 1955.

A P P E N D I X

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according

to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4).

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum

of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

* * * * *

(26 U. S. C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23 (a)-1. *Business expenses*.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *

SEC. 29.23 (a)-10. *Rentals*.—If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum for each year, based on the number of years the lease has to run. * * *

* * * * *

SEC. 29.23 (m)-1. [As amended by T. D. 5413, 1944 Cum. Bull. 124]. *Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements*.—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. However, no depletion deduction shall be allowed with respect to any timber which the owner has disposed of under any form of contract by virtue of which the owner retains an economic interest in such timber, if such disposal is considered a sale of the timber under section 117 (k) (2) of the Code. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

The adjusted basis of depreciable property is returnable through annual depreciation deductions. Depreciation and depletion deductions on the property of a corporation are allowed to the corporation and not to its shareholders. * * *

When used in these sections (29.23 (m)-1 to 29.23 (m)-28, inclusive) covering depletion and depreciation—

* * * * *

(b) A “mineral property” is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes

of mineral extraction. The value of a mineral property is the combined value of its component parts.

(c) The term "mineral deposit" refers to minerals in place. The cost of a mineral is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(d) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, * * * barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, * * * limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, * * * sulphur, talc, * * *.

* * * * *

SEC. 29.23 (m)-10. *Depletion—Adjustments of Accounts Based on Bonus or Advanced Royalty.*—(a) If a bonus in addition to royalties is received upon the grant of rights in mineral property, there shall be allowed to the payee as a depletion deduction in respect of the bonus an amount equal to that proportion of the basis for depletion as provided in section 114 (b) (1) or (2) which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the payee's basis for depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received. In the case of the payor any payment made for the acquisition of an economic interest in a mineral deposit or standing timber constitutes a capital investment in the property recoverable only through the depletion allowance.

(b) If the owner of operating rights in mineral property for a term of years is required

to extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or to pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the premises, the payee shall treat an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction as an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by such payee shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any grant of mineral rights expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the grantor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which such expiration, termination, or abandonment occurs.

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No. 14735

IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER

— vs. —

ROBERT H. MILLER AND DORIS K. MILLER,
RESPONDENTS

ON PETITION FOR REVIEW OF THE DECISION OF
THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENTS

MAX B. LEWIS
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FILE

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ROBERT H. MILLER AND DORIS K. MILLER,
RESPONDENTS

ON PETITION FOR REVIEW OF THE DECISION OF
THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENTS

QUESTION PRESENTED

Whether the rentals paid by Respondents for the first year of the term of the Federal oil and gas leases are, in fact, true rentals and deductible under Section 23 (a) (1) (A) and Section 23 (a) (2) of the Internal Revenue Code of 1939.

STATEMENT OF FACTS

The Respondents are not in disagreement with the Statement of Facts as described on pages 2 to 6, inclusive, of Petitioner's brief except in so far as stated herein. At page 5 of his brief Petitioner quotes from Section 1 of the Noncompetitive Oil and Gas Leases issued to the partnerships of which Respondents were partners. A portion of Section 1 as quoted by the Petitioner reads:

"That the Lessor, in consideration of rents and royalties to be paid, and the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the Lessees the exclusive right and privilege * * *."

Further, at page 8 of Petitioner's brief, the following statement is made:

"Although the advance payments in question are termed, variously, rents, rentals and/or royalties in the leases, this is clearly not significant for the pertinent decisions hold that these are all the same in nature and substance as advance royalties and so-called bonuses which the Lessee must capitalize and recover through depletion deductions."

In view of the fact that the above quoted portions of Section 1 of the leases, together with the above statement made by the Petitioner on page 8 of his brief may give rise to a misunderstanding, the Respondents desire to present as an absolute factual matter that the payments in question were designated and referred to solely as "rents" or "rentals" in the leases and wherever the leases used the terms "royalties" or "advance royalties," such terms were intended to refer to obligations other than the payments involved in this case. In support of this contention, the Respondents desire to quote the pertinent language from

the leases which refer to the payments in question in this case. Section 2 (d) of the leases (R. 36) states as follows:

“(d) Rentals and royalties — (1) To pay the rentals and royalties set out in the rental and royalty schedule attached hereto and made a part hereof.”

Schedule “A” to the leases appears in the Transcript of Record (R. 53) and is quoted as follows:

“Schedule ‘A’

Rentals and Royalties

Rentals — To pay the lessor in advance on the first day of the month in which the lease issues a rental at the following rates:

(a) If the lands are wholly outside the known geologic structure of a producing oil or gas field:

(1) For the first lease year, a rental of 50 cents per acre.

(2) For the second and third lease years, no rental.

(3) For the fourth and fifth years, 25 cents per acre.

(4) For the sixth and each succeeding year, 50 cents per acre.

(b) On leases wholly or partly within the geologic structure of a producing oil or gas field:

(1) Beginning with the first lease year after 30 days’ notice that all or part of the land is included in such a structure and for each year thereafter, prior to a discovery of oil or gas on the lands herein, \$1 per acre.

(2) On the lands committed to an approved Co-operative or unit plan which includes

a well capable of producing oil or gas and contains a general provision for allocation of production, for the lands not within the participating area an annual rental of 50 cents per acre for the first and each succeeding lease year following discovery.

Minimum royalty—To pay the lessor in lieu of rental at the expiration of each lease year after discovery a minimum royalty of \$1 per acre or, if there is production, the difference between the actual royalty paid during the year and the prescribed minimum royalty of \$1 per acre, provided that on unitized leases, the minimum royalty shall be payable only on the participating acreage.

Royalty on production—To pay the lessor 12½ per cent royalty on the production removed or sold from the leased lands.

The average production per well per day for oil and for gas shall be determined pursuant to 30 CFR, Part 221, 'Oil and Gas Operating Regulations'.

In determining the amount or value of gas and liquid products produced, the amount or value shall be net after an allowance for the cost of manufacture. The allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior."

The payments in question in this case are only those specified in subparagraph (a) (1) of Schedule "A" above; at no place, whether the same be the provisions of the Act of February 25, 1920, as amended by the Act of August 8, 1946, or the instant leases, can it be said that such payments were called royalties or anything other than "rents" or "rentals".

SUMMARY OF ARGUMENT

The payments here involved were intended by Congress to be and were, in fact, true rentals, i.e., one of a series or periodic payments made for the use of leased property for a specified period of time. As such they were deductible under Section 23 (a) (1) (A) of the Internal Revenue Code of 1939 if paid by Respondents pursuant to a trade or business, or under Section 23 (a) (2) if not paid by Respondents pursuant to a trade or business.

ARGUMENT

POINT I.

ANALYSIS OF PETITIONER'S ARGUMENT

Petitioner contends that the payments made by Respondents for the first year of the lease term of certain Federal oil and gas leases and denominated "rentals" are, in fact, non-deductible, capital outlays. Petitioner in his brief advances two arguments:

- (1) That the payments here involved were made for the acquisition of a so-called "economic interest" and hence must be capitalized;
- (2) Since by virtue of these leases Respondents had an "economic interest" in the oil and gas in place, entitling them to a depletion allowance, all payments (except delay rentals) made by the Lessee-Respondents to the United States must perforce be capitalized.

POINT II.

PURSUANT TO THE INTENTION OF THE PARTIES THE PAYMENTS HERE INVOLVED WERE MADE FOR THE USE OF THE LEASED PREMISES FOR A SPECIFIED PERIOD OF TIME AND WERE TRUE RENTALS.

Petitioner argues that the payments here involved were made for the acquisition of an "economic interest" in oil and gas in place. The term "economic interest" was developed, as is later discussed, in connection with the allowance for depletion, i.e., a person who had this "economic interest" was entitled to the depletion deduction.

Admittedly, as lessees of Federal oil and gas leases Respondents would have the right to take depletion on production and thus had an "economic interest". The question, however, is whether the payment here involved was made as the purchase price for this "economic interest", i.e., the lease, and thus is what is known as bonus or advance royalty, or whether the payment is, in fact, true rental.

To determine the true nature and purpose of the payment, the meaning of the word "rental" found in Section 23 (a) (1) (A), Internal Revenue Code, 1939, must be determined. It is also essential to know whether Congress intended the payments here involved and denominated "rental" to be, in fact, rental and to serve the function of rental or whether the intent was that it be "bonus".

First, what is meant by "rental" as the word is employed in Section 23 (a) (1) (A), *supra*, and what is "bonus", sometimes referred to as "advance royalty"? Both concepts are, of course, employed in non-mineral as well as in mineral leases.

The meaning of the word "rental", employed in the rental deduction provisions of the Act of 1916, which provisions have been re-enacted without substantial change as Section 23 (a) (1) (A), has been considered by the Supreme Court of the United States. That Court found the meaning to be:

"The term 'rentals' since there is nothing to indicate the contrary, must be taken in its usual and ordinary sense, that is, as *implying a fixed sum, or property amounting to a fixed sum, to be paid at stated times for the use of property.*" (Emphasis supplied.) *Duffy v. Central Railroad of New Jersey*, 268 U.S. 55, 45 S. Ct. 429 at 431 (1924).

Bonus, in contrast to rent, is a single non-recurring payment which is paid for the lease. It is consideration for the *entire* lease and, therefore, as cost of the lease, must be capitalized.

In a non-mineral lease, bonus is amortized over the term of the lease, i.e., prorated against income for the operation of the leased premises as that income accrues over the years. In *Galatoire Brothers v. Lines, Collector of Internal Revenue*, 23 F. 2d 676 (5th Cir. 1928), the lessee paid the landlord a sum in addition to rent, and the Court held that that sum was bonus and that, although the rent was currently deductible, the bonus must be capitalized and amortized. See *Kekaha Sugar Company, Ltd. v. Burnet*, 50 F. 2d 322 (D.C. Cir. 1931) and *J. Alland & Bro. Inc. v. United States*, 28 F. 2d 792 (D.C. Mass. 1928) where the taxpayer paid a lessee a sum for an assignment of the leasehold interest, in addition to agreeing to pay the rent, and the Court held that said sum was bonus and must be capitalized and amortized. See also *Reg. 111, Section 29.23 (a)-10.*

In a mineral lease, the single, non-recurring payment paid for the entire lease and for no specified portion of the lease term, denominated bonus, is considered as advance royalty. The bonus is considered to be a payment in advance for oil and gas to be removed.

“On the other hand, royalties, including bonus, are not paid for time but for oil and gas taken out, and represent an actual removal and disposition of the contents of the soil.” *Commissioner v. Wilson*, 76 F. 2d 766. (5th Cir. 1935).

“A bonus is not proceeds from the sale of property, but payment in advance for oil and gas to be extracted, and is therefore taxable income.” *Herring v. Commissioner*, 293 U.S. 322, 55 S. Ct. 179 (1934).

Bonus is ordinary income to the recipient subject to the depletion deduction. *Burnet v. Harmel*, 287 U.S. 103, 53 S. Ct. 74 (1932); *Murphy Oil Company v. Burnet*, 287 U.S. 299, 53 S. Ct. 161 (1932); *Palmer v. Bender*, 287 U.S. 551, 53 S. Ct. 225 (1933); *Herring v. Commissioner*, supra. The payer of the bonus, since the bonus is considered advance royalty, must recover the bonus through depletion as production income accrues. *Sunray Oil Company v. Commissioner*, 147 F. 2d 692 (10th Cir. 1945); *Canadian River Gas Co. v. Higgins*, 151 F. 2d 954 (2nd Cir. 1945); *Quintana Petroleum Co. v. Commissioner*, 143 F. 2d 588 (5th Cir. 1944); *Baton Coal Co. v. Commissioner*, 51 F. 2d 469 (3rd Cir. 1931). See also *Reg. 111, Section 29.23 (m)-10 (A)*.

From an examination of the above mentioned cases, it can be seen that the essential difference between rental and bonus is that rental is a periodic payment paid to hold

property for specified portions of the lease term, whereas bonus is a single, non-recurring payment paid for the lease as a whole.

With this in mind, it may be helpful to examine the successive acts of Congress under which the public domain was leased for oil and gas purposes. It is believed that this examination will aid in the determination of whether the rental herein involved was, in fact, one of a series of periodic payments made at stated times for the use of property or was a single payment made for the "economic interest", i.e., the lease. If the former, it should be deductible as paid; whereas if it is the latter it should be recouped through depletion over the lease term.

Prior to 1920, oil and gas prospecting on the public domain was authorized only under the Act of May 10, 1872 (17 Stat. 91), as amended by the Act of 1897 (29 Stat. 526). These Acts, being primarily designed for the mining industry, were not adaptable to the needs of oil and gas exploration, development and production.

Therefore, in 1920, Congress enacted the first oil and gas leasing act (Leasing Act of February 25, 1920, 41 Stat. 437). Under this Act an applicant received a two-year prospecting permit and if, prior to the expiration of this permit, he made discovery of a valuable deposit of oil or gas, he had the right to lease one-fourth of the acreage covered by the permit at a five per cent royalty. He further had a preferential right to lease the balance of the acreage covered by the permit at a royalty of not less than twelve and

one-half per cent. *Section 14, Leasing Act of February 25, 1920*, 41 Stat. 437. The Act further provided that all lands within a "known geological structure of a producing oil or gas field" and not covered by a prospecting permit would be leased by competitive bidding "upon payment by the lessee of such *bonus* as may be accepted and of such royalty as may be fixed in the lease". *Section 17, Leasing Act of February 25, 1920*, *supra*.

This method of oil and gas development of the public domain proved unsatisfactory and, therefore, in 1935, Congress radically revised the Leasing Act of 1920 by enacting an amendatory act, Act of August 21, 1935, 49 Stat. 674.

Under the 1935 Act, prospecting permits were abolished except for those then existing and those filed ninety days after the effective date of the Act. For the prospecting permit system, there was substituted a procedure by which leases on lands not within a known geological structure of a producing oil and gas field were granted to the first qualified applicant at a royalty of twelve and one-half per cent where production did not exceed fifty (50) barrels per well per day and of not less than twelve and one-half per cent when production exceeded that figure. On the other hand, the issuance of leases on lands within a known geological structure were "conditioned upon the payment by the lessee of such *bonus* as may be accepted" and of such royalty as may be fixed. On all leases, whether within or without a known geological structure, there was required the payment of a rental of "not less than twenty-five cents per acre". *Section 17, Leasing Act of February 25, 1920*, *supra*, as amended by *Act of August 21, 1935*, *supra*.

In 1940, (Act of July 8, 1940, 54 Stat. 742), Congress amended the 1935 Act by waiving advance rentals for the second and third years of the lease term.

In 1946, Congress again re-examined the entire procedure for leasing public domain lands for oil and gas purposes and finding that the existing system did not sufficiently encourage exploration on the public domain, enacted, after prolonged hearings, the Act of August 8, 1946 (60 Stat. 950, 30 U.S.C. 181 et seq. (Supp. 1946)). In that Act the number of acres which any one person could hold under oil and gas lease was increased to 14,360 acres in any one state, the royalty on non-competitive leases, i.e., leases issued without the payment of a bonus, was limited to twelve and one-half per cent and for the first time citizens were granted the privilege of holding, in addition to their lease acreage, acreage under option not to exceed 100,000 acres in any one state. The Act further provided for the payment of advance rentals annually on all leases, whether competitive or non-competitive, but maintained the principle of the amendatory Act of July 8, 1940, *supra*, by waiving rentals for the second and third years of the lease term.

The relevant portions of the 1946 Act are set forth below:

"When the lands to be leased are within any known geological structure of a producing oil or gas field, they shall be leased to the highest responsible qualified bidder by competitive bidding under general regulations, in units of not exceeding six hundred and forty acres, which shall be as nearly compact in form as possible upon the payment by the lessee of such bonus as may be accepted by the

Secretary and of such royalty as may be fixed in the lease which shall not be less than 12½ per centum in amount or value of the production removed or sold from the lease. *When the lands to be leased are not within any known geological structure of a producing oil or gas field, the person first making application for the lease who is qualified to hold a lease under this Act shall be entitled to a lease of such lands without competitive bidding.* Such leases shall be conditioned upon the payment by the lessee of a royalty of 12½ per centum in amount or value of the production removed or sold from the lease . . . *All leases issued under this section shall be conditioned upon the payment by the lessee in advance of a rental of not less than 25 cents per acre per annum.* A minimum royalty of \$1.00 per acre in lieu of rental shall be payable at the expiration of each lease year beginning on or after a discovery of oil or gas in paying quantities on the lands leased; PROVIDED, that in the case of lands not within any known geological structure of a producing oil or gas field, the rentals for the second and third lease years shall be waived unless a valuable deposit of oil or gas be sooner discovered.” (Emphasis supplied.) *Section 3, Act of August 8, 1946, 60 Stat. 950, 30 U.S.C. 226 (Supp. 1946).*

Thus, both in the 1935 and in the 1946 Acts, Congress sharply distinguished between leases on lands within a known geological structure and those not within a known geological structure. To obtain a lease on the former, payment of a bonus was required; whereas, as to the latter, leases were issued to the first qualified applicant, no bonus being required. Nevertheless, on leases of both types, and thus irrespective of whether a bonus was paid or not, Congress required the payment, annually and in advance, of a rental of not less than 25 cents an acre.

A study of the Leasing Acts of 1935 and of 1946 reveals that Congress had clearly in mind the distinction between bonus and rental, purposefully determining to sell leases, i.e., charge a bonus, on lands within a known structure. Equally clearly, Congress determined not to "sell" leases on unproven lands but determined that every qualified citizen should have the right to obtain a lease on such lands provided he makes the first application. On both types of leases, Congress legislated that the holding charge of not less than 25 cents per acre per year should be paid.

The impression created from a reading of the Leasing Act as to Congressional intent is amply borne out by a study of the history of each of the Acts. Furthermore, it is eminently reasonable that Congress should have distinguished between the two types of leases. It is highly logical that when dealing with proven lands Congress would require a payment in advance for the oil and gas to be extracted, i.e., a bonus payment. Such a payment would obviously be advance royalty and subject to capitalization. It is equally logical that Congress would require no such payment when dealing with wildcat lands, but should grant leases on such land to the first qualified applicant who paid the filing fee.

The failure to "sell" and require competitive bids and bonus payments on lands not within a known geological structure did not come about without argument. The Department of the Interior strenuously argued that all oil and gas leases should be sold and that a bonus should be paid for all. *Sen. Rep. No. 1158, Committee on Public Lands and Surveys, 74th Congress, 1st Session, Page 3*, contains

a significant letter from Harold L. Ickes, then Secretary of the Interior, dated February 26, 1935, and addressed to the Committee Chairman.

In this letter, Mr. Ickes reviews the general custom of leasing private and public lands :

“Under the general custom of leasing lands for the discovery and production of oil and gas from the early days of the industry, the lessee pays the lessor a bonus in cash for the privilege of leasing and a percentage royalty on production obtained. The amount of bonus and royalty paid for private lands has been a matter for trading between the interested parties. For public lands, the percentage royalty has most generally been fixed by law or regulation and the bonus determined by competitive bidding. In most cases a royalty of $12\frac{1}{2}$ per cent, plus a cash bonus in dollars per acre, has been the result, though royalties of $16\frac{2}{3}$ per cent are not uncommon and higher royalties have been obtained under exceptional conditions. Royalties of less than $12\frac{1}{2}$ per cent have been practically unknown in the industry.”

Mr. Ickes protested that the 1920 Act departed from this established custom as to oil and gas leasing, and that the provision of the 1935 Act granting leases to first qualified applicants on lands not within a known geological structure perpetuated this departure from established custom and was subversive to public interest in that no bonus was charged for this type of lease. He argued strenuously that a bonus should be charged on all leases and the provision in the then proposed legislation permitting leases on lands not within a known geological structure to issue, without bonus payments, to first qualified applicants, be eliminated.

See also *H. R. Rep. No. 1101, Committee on Public Lands, 74th Congress, First Session (1935)* and *H.R. Rep. No. 1747, Committee on Public Lands, 74th Congress, First Session (1935)* wherein the same letter is published.

Despite this vigorous protest by the Department of the Interior, Congress refused to sell, i.e., charge a bonus on, leases of lands not within a known geological structure, but authorized their issuance on a first-come first-served basis.

In 1946, when Congress was again considering amending the Leasing Act, the same objection was raised by the Department of the Interior. Furthermore, the Department apparently felt that the proposed legislation restricted the area of competitive bidding even more than did the 1935 Act. We cannot see that such is the case; however, it is the attitude of the Department of the Interior which is important. See letter dated March 15, 1946, from Acting Secretary of the Interior, Oscar L. Chapman, to the Chairman of the Committee on Public Lands and Surveys, United States Senate, *Sen. Rep. No. 1392, 79th Congress, Second Session (1946)*, Page 6.

A similar protest was made by the Secretary of the Interior, J. A. Krug, to the Chairman of the Committee on Public Lands, House of Representatives. See *H. R. Rep. No. 2446, 79th Congress, Second Session (1946)*, Page 5. Furthermore, the Secretary protested even more strenuously to the Committee on Public Lands and Surveys at hearings held at Washington, D.C., May 7, 8 and 9, 1946. At these hearings, the Secretary stated:

"The Government would be prevented by this provision from realizing a revenue from many areas which are reasonably believed to contain oil and gas but which have not been proved to be productive.

Since neither this Department nor the Department of Agriculture, as a rule, has experienced difficulty in finding bidders for any land offered for lease, it is apparent that there is no necessity for such a restriction in order to promote prospecting.

As a matter of fact, I understand that the Department of Agriculture feels that this Department has been too conservative in offering prospective lands for bidding, and that it believes leases should be sold rather than issued upon non-competitive applications, in any area where an active competitive interest is found to exist.

There is merit in this assumption from the standpoint, at least of revenue for the people of the West, who are the ultimate beneficiaries of the fiscal provisions of the Mineral Leasing Act.

The practice of offering unproven lands for competitive bidding is followed by many states with respect to some or all of their own lands.

New Mexico, in particular, appears to have found it profitable to do so, as it collected over \$1,000,000 bonuses during the fiscal year 1944.

Most private landowners also obtain some bonus for a lease. In any event, there can be no substantial argument against the sale of leases on lands reasonably believed to contain oil and gas, whether that belief is based on their relation to known oil lands or as the result of geologic inference. *Hearings before the Committee on Public Lands and Surveys, on S. 1236, 79th Congress, Second Session (1946), Page 238."*

The same type of protest was made by Mr. J. D. Wolfsohn, Assistant Commissioner of the General Land Office, Department of the Interior, who stated to the Committee on Public Lands and Surveys as follows:

"I see no reason why the United States should make a free grant of the right to lease land reasonably believed to contain oil or gas which a state or a private owner would be able to sell for a substantial sum." Hearings before the Committee on Public Lands and Surveys on S. 1236, 79th Congress, Second Session (1946). (Page 254).

An early draft of the 1946 Act provided for the transfer of Department of Agriculture lands to the Department of the Interior for oil and gas leasing purposes. The Secretary of Agriculture, Clinton P. Anderson, addressed a letter dated March 8, 1946, to the Chairman of the Committee on Public Lands and Surveys, in which the Secretary of Agriculture expressed concern as to the loss of revenue which would result from leasing lands not within a known geological structure, without requiring a bonus. He stated as follows:

"Aside from the question of administrative coordination, S. 1236 presents an important question of public policy, namely, the procedure to be followed in disposing of oil and gas privileges in lands which are not within the known geologic structure of a producing oil and gas field. Under the procedures of the Federal Mineral Leasing Act, such lands are subject to the principle of first in time, first in right, the first qualified applicant establishing a preference or priority under which the payment of a filing fee is all that is required, no competitive bid or bonus being necessary. The oil and gas regulations of this Department are based on a different princi-

ple, namely, that if an active competitive interest is found to exist within a particular territory the oil and gas privileges will be disposed of only by competitive bid even though the lands are not within the known geologic structure of a producing field." *Reports submitted to Committee on Public Lands and Surveys by the Department of the Interior and the Department of Agriculture, 79th Congress, Second Session (1946) (Committee Print).*

The Secretary then demonstrated the loss of revenue which would have been sustained had the 1935 Act applied to agricultural lands and the Department of Agriculture had been unable to charge bonuses except when lands were within a known geological structure.

Apparently as a result of this protest, agricultural lands were eliminated from the bill. Nevertheless, the protests of the Department of the Interior were in vain and the bill was enacted as proposed, resulting only in the selling of leases on lands within a known geological structure.

It would, therefore, appear that the purpose of the bill as stated by Senator O'Mahoney prevailed.

"The bill is designed to stimulate the discovery of new petroleum reserves; to promote the development of oil and gas on some 300,000 square miles of potential oil lands of the public domain; to grant incentives which will bear as their rewards American leadership in industry and world affairs." *Sen. Rep. No. 1392, 79th Congress, Second Session (1946), Page 1.*

As a further indication that Congress was fully aware of the difference between bonus and rental, it is interesting

to note that Acting Secretary of the Interior, Oscar L. Chapman, in his letter previously mentioned, protested the waiver of second and third year rentals on the grounds that no one should be permitted to "hold public land rent free". He stated as follows:

"It is recommended that the Act (Act of July 8, 1940) be repealed and that the provision contained in S. 1236 be deleted. There is no reason for permitting a lessee to hold public land *rent free* without development. The relatively low rate of rental of 50 cents per acre for the first year and 25 cents an acre for each subsequent lease year charged for undeveloped federal lands is sufficiently low to encourage the acquisition of leases without waiver of the second and third year rentals." *Sen. Rep. No. 1392, 79th Congress, Second Session (1946), Page 10.*

In summary, Congress was clearly aware of the difference between bonus and rental and purposefully refused to sell leases, i.e., charge a bonus, on leases not within a known geological structure. Congress did, however, charge rentals on all leases, whether within or without a known geological structure, but explicitly waived rentals for the second and third years on non-competitive leases.

The Leasing Act and the legislative history of the Act clearly shows that Congress intended lessees to purchase the "economic interest" granted by a lease where the lands are within a known geological structure, payment of a bonus being provided. On the other hand, where the lands are not within a known geological structure, Congress intended as a matter of policy to make a "free grant" of the lease (economic interest) to the first qualified applicant. Congress required that annual rentals be paid on both types of leases.

In view of the clear understanding of Congress of the difference between bonus and rental and the different function of each, and further, in view of the specific and considered Congressional refusal to charge a bonus on the type of lease herein involved, Respondents respectfully submit that the statement of Petitioner that the rentals were paid *for* the "economic interest", i.e., as purchase price of the lease, is erroneous and that Petitioner's effort to convert rental into bonus or advance royalty should fail.

Petitioner argues that the lease form supports his contention. He states that Section 1 grants the lease "in consideration of rents and royalties to be paid and the conditions and covenants to be observed." Obviously, all leases of whatsoever nature are granted in consideration of the rents and other covenants to be observed. This does not mean, however, that rents are not rents and must be capitalized. Nor do other provisions of the lease discussed by Petitioner seem significant, i.e., that the lessee has the right to use the surface of the lands, that second and third year rentals are waived, and that a lessee could assign or sublease.

Petitioner devotes a large portion of his brief to the proposition that a bonus, i.e., a payment made for the "economic interest", must be capitalized, and recouped through depletion deductions as oil and gas is produced, or if no oil and gas is produced, then as a deduction in the year of surrender of the lease. Respondents agree with this statement. Unquestionably, where the payment is a bonus the consequences mentioned above follow. This is the holding of

Sunray Oil Co. v. Commissioner, supra, and *Canadian River Gas Co. v. Higgins*, supra, both of which are discussed at great length by Petitioner in his brief. It is also the holding of *Quintana Petroleum Co. v. Commissioner*, supra, and *Baton Coal Co. v. Commissioner*, supra, cited in Petitioner's brief; it is the substance of *Regulation 111, Section 29.23 (m)-1* and *(m)-10* to the Internal Revenue Code, mentioned in Petitioner's brief. To the extent that *Jefferson Lake Sulphur Co. v. Lambert*, (E.D. La.), decided June 29, 1955 (1955 P-H, Par. 72, 863), conflicts with the above decisions we concur with Petitioner that it is wrongly decided.

All this, however, begs the question. Obviously if the payment here involved is for the acquisition of the leasehold and thus is a bonus, it must be capitalized. The essential question to be decided is what is the true nature of the payment here involved; Petitioner never attempts to answer this question, but assumes that the payments were bonuses.

Petitioner states that the name given the payment should not be controlling and cites *Southwestern Hotel Co. v. U.S.*, 115 F. 2d 686 (1940), where the Fifth Circuit, in discussing whether certain payments made pursuant to a mineral lease should be capitalized correctly refused to allow the name given to the payment to control, stating:

“If the name controlled the fact, this tax could be avoided by the ignorant by chance misnomer or by the learned by intentional misnomer.” (At page 688).

Respondents concur that the name given the payment should not control and that “the ignorant by chance misnomer or . . . the learned by intentional misnomer” should not avoid a tax. However, Congress, when it employed the word “rental” was not ignorant of the distinction between rental and bonus, but was extremely well informed concerning the substance and true nature and meaning of the terms. The legislative history of the Leasing Act shows that Congress employed the term “rental” because the term expressed the true substance of what Congress intended the payment to be. Furthermore, Respondents cannot believe that Petitioner contends that Congress was guilty of “an intentional misnomer”.

POINT III.

ESTABLISHED PRECEDENTS SUPPORT THE DECISION OF THE COURT BELOW.

In addition to the foregoing, the Petitioner appears to argue that since lessees under Federal oil and gas leases have an “economic interest” in the oil and gas in place, all payments by the lessee to the lessor (except delay rentals) must be capitalized.

The “economic interest” concept was developed to assist in determining when a taxpayer was entitled to the depletion allowance on production royalties or advance royalties. *Burnet v. Harmel*, supra; *Murphy Oil Co. v. Burnet*, supra; *Palmer v. Bender*, supra; *Herring v. Commissioner*, supra; *Burton-Sutton Oil Co. v. Commissioner*, 328 U.S. 25, 90 L. Ed. 1062 (1945). As stated in the *Burton-Sutton* case and as quoted by Petitioner in his brief a taxpayer has an “economic interest” in oil and gas in place when his “possibility of profit” depends “solely upon the

extraction and sale of the oil". If a taxpayer has this economic interest, he is then entitled to the depletion allowance.

There is no question but that the lessee of a Federal oil and gas lease is entitled to depletion on production from that lease and has the necessary "economic interest" to support the depletion deduction. It is a non sequitur, however, to say that because a lessee has this economic interest, all payments which he makes to the lessor, except so-called "delay" rentals, must be capitalized.

Obviously no such rule has been adopted by the courts. The courts have examined each payment made by a lessee to a lessor to determine its true nature, i.e., whether it be truly a rental and thus deductible or bonus and thus non-deductible.

In determining the true nature of the payment, the lease agreement, the name given the payment and the intent of the parties are of first importance. In *Continental Oil Co.*, 36 B.T.A. 693 (1937), the lease agreement provided for a five year lease extension upon the payment annually of a specified sum. The court, relying on the expressed intent of the parties, held as follows:

"It appears to us that parties to the contract plainly indicated therein their intention that the advance yearly payments for the annual extensions of the leases should not be considered as payments for mineral until production began and that the payment in question here was made for rental 'without operations or production' merely to hold the property until the lessee should bring it into production." (At Page 698).

Similarly in *Houston Farms Development Co. v. United States*, 131 F. 2d 577 (5th Cir., 1942), the court looked to the agreement to determine the nature of the payment and stated:

“Whether the \$25,000 paid was for mere delay, rather than for oil expected to be produced, is best ascertained from the agreement of the parties.” (At Page 579).

Where the expressed intent of the parties is not in accord with their true intent as observed through the indicia of the payment, the courts have ignored the expressed intent. For instance, in *Charles H. Merillat*, 9 B.T.A. 813 (1927), a payment called “advance royalties” was held, in fact, to be rental and, therefore, deductible. On the other hand, in *James Lewis Caldwell McFaddin*, 2 T.C. 395 (1943), a payment called “rental” was held to be minimum royalty.

In *Alice G. K. Kleberg*, 43 B.T.A. 277 (1941), the agreement provided for annual rentals of \$3,957.07 but further provided that they be discounted to present value and paid one-half in 1933 and one-half in 1934. The Court viewed the transaction as follows:

“Petitioner in consideration of the payment of \$49,313.83 payable to her in two installments plus a reserve oil and gas royalty of one-eighth ($\frac{1}{8}$) of the oil and gas to be produced leased her 30,439 acre tract for a period of twenty years, and thereafter as to any developed structures for so long as production is had from such structures. Under this state of facts, we hold that the \$24,656.92 received by Petitioner in 1933, was a bonus in the nature of advance royalties and that Petitioner is entitled to percentage depletion thereon.” (At Page 294).

Petitioner concedes that a "delay" rental may be deducted. See Petitioner's brief, pages 9 and 10. The typical delay rental, in the words of Petitioner, secures "for the payor the right to hold the leases for the succeeding year or years without the necessity of drilling wells or making further payments except royalties on the minerals produced".

Petitioner must consider delay rentals not to be rent. Otherwise he could not concede their deductibility. The courts, however, have held these delay rentals deductible, not because they are different from rent, but because, in fact, they are true rents. In *Commissioner v. Wilson*, supra, the Court stated:

"The 'delay rentals' on oil and gas leases are rents within the rule just announced. They accrue by the mere lapse of time like any other rent. They do not depend on the finding or production of oil or gas and do not exhaust the substance of the land. While having some likeness to a bonus payment which is held to be advance royalty, *Murphy Oil Co. v. Burnet*, 287 U.S. 299, 53 S. Ct. 161, 77 L. Ed. 318; *Burnet, Commissioner v. Harmel*, 287 U.S. 103, 53 S. Ct. 74, 77 L. Ed. 199, the delay rental is not paid directly or indirectly for oil to be produced, but is for additional time in which to utilize the land. We hold it to be rent. *Caruthers v. Leonard*, (Tex. Comm. App.) 254 S.W. 779, 783; *Sneed v. Commissioner*, 30 B.T.A. 1121.

"On the other hand, royalties, including bonus, are not paid for time but for oil and gas taken out, and represent an actual removal and disposition of the contents of the soil." (At Page 769).

This language was quoted with approval in *J. T. Sneed, Jr.*, 33 B.T.A. 478, 483 (1935). See also *I.T.* 3401, 1940-2,

C.B. 199, where Petitioner himself states "there is no distinction between the term 'rent' in the sense that that term ordinarily is used and 'delay rentals'."

Furthermore, rentals which have been held to be deductible are by no means confined to delay rentals. In *Houston Farms Development Co. v. United States*, *supra*, the taxpayer took 5,000 acres of land under a so-called selection lease. The lease agreement provided that the lease would terminate within fifty-five days "unless on or before that date, lessee, at its election, pays to lessor . . . \$12.50 per acre for all or such part of the land as lessee desires to retain." At the end of each successive year thereafter the lease agreement provided for the payment of a typical "delay rental" of \$5.00 an acre. Prior to the end of the fifty-five days, the lessee selected certain land and paid at the rate of \$12.50 per acre. The Court found the payment to be "in the nature of rent" and thus deductible.

In the *Merillat* case, *supra*, the lessee, among other expenditures, paid a sum on an oil and gas lease pursuant to a lease provision which stated that "until a producing well is completed on said premises the lessee shall pay . . . as advance royalty . . . fifteen cents per acre per annum in advance for the first and second years, thirty cents per acre per annum in advance for the third and fourth years". The Court there held the payments to be rental and thus deductible.

In *Continental Oil Co.*, *supra*, where annual cash payments were to be made until production was obtained, the Court found that the payment was made "merely to hold the property until the lessee should bring it into production". It, therefore, was rental.

The above cases did not involve "delay" rentals; however, the courts found the payments to be rentals and, therefore permitted the deduction. Thus the conclusion of Petitioner, that prior to *Olen F. Featherstone*, 22 T.C. 763 (1954) and *United States v. Dougan*, 214 F. 2d 511 (10th Cir. 1954) only technical delay rentals were deductible, is erroneous.

The mechanical rule argued for by Petitioner, i.e., that all payments except delay rentals made by a mineral lessee to a mineral lessor must be capitalized, leads to absurd situations. For instance, under the Leasing Act, Congress provided that leases on known geological structures should be sold and a bonus paid therefor, but that leases on other lands should be issued to the first qualified applicant. Congress required payment of annual rentals on both types of lease.

Petitioner would have lessees capitalize the rental as well as the bonus apparently on the grounds that the nature and purpose of both payments are identical. The absurdity of this argument is readily apparent. Congress recognized a difference between bonus and rental, and over the objection of the Department of the Interior, provided that leases on lands outside known geological structures should not be sold but that a free grant of such leases should be made to the first qualified applicant. Congress recognized that the rental was a charge which held land for specified periods. As previously discussed, the waiver of the rental for the second and third year of the lease term was strenuously but unsuccessfully objected to by the Department of the Interior on the grounds that no Federal lands should be held "rent free".

If Petitioner's argument should prevail a similar situation would arise in the instance of certain leases on state lands. For instance, in New Mexico, the statutes (New Mexico Statutes Annotated 1953, Title 7, Chapter 11, Sections 9 and 10) confer on the Commissioner of Public Lands the authority to sell leases, i.e., charge bonuses, in areas of his choosing. If Petitioner's argument should prevail, the bonus required to be paid by the Commissioner on certain lands and the annual rental which the statute provides must be paid on all lands would be treated as one and the same type of payment.

Petitioner relies on *Jefferson Lake Sulphur Co. v. Lambert*, supra, the holding of which he states is contrary to the *Featherstone* and *Dougan* cases. There, the lessee of a mineral lease agreed to pay \$300,000. This \$300,000 was payable in quarterly installments of \$7,500 each during the years of a ten year primary term. The taxpayer argued that these installment payments were deductible as rentals under Section 23 (a) (1) (A), Internal Revenue Code, 1939. The Court said that the taxpayer's position was supported by the *Dougan* and *Featherstone* cases, supra, but indicated it felt the cases were wrongly decided.

The factual situations in the *Dougan* and the *Featherstone* cases are entirely different from the factual situation in the *Jefferson Lake* case, where the payments in question were installments of a \$300,000 bonus. Therefore, Respondents submit that in the *Jefferson Lake* case a true bonus was involved, and the case cannot be used as authority contra to the *Dougan* and *Featherstone* cases.

The logical difficulty in attempting to confine true rentals to "delay" rentals was well stated by the Court in the *Featherstone* case:

“ . . . Respondent would have us distinguish between delay rentals and the first year payments involved in this proceeding. It is our opinion, however, that the two differently styled payments are nevertheless in substance the same. Both are fixed sums paid in advance to secure for the payor the right to hold the lease for the succeeding year or designated period without the necessity of drilling wells or making further payments, except royalties on the mineral produced. Neither payment is deemed compensation for the mineral extracted from the soil, although, in the event of production, the first-year payment may be credited against current royalties. But that would be true also of payments for subsequent lease years, which payments respondent here concedes are deductible. Moreover, even if it is true, as respondent alleges, that a lessee acquires an economic interest in oil or gas in place upon making a first-year payment, it is, in our opinion, equally true that a lessee retains a similar interest on paying a delay rental. It would seem then that the delay rentals possess no fewer attributes of a ‘capital investment’ than do the annual payments in the case at bar. Yet for tax purposes it is undisputed that delay rentals are deductible by the payor and non-depletable by the payee . . . ”

The Tenth Circuit in the *Dougan* case, *supra*, held that first year rentals paid on Federal oil and gas leases were true rentals and in support of its holding, pointed to well established authorities.

“The payments here were made as a condition for the continued use and possession of a defeasible interest in the minerals quite as much as advance payments for annual extension of leases in *Continental Oil Co. v. Commissioner*, 36 B.T.A. 693, or the delay rentals in *Sneed v. Commissioner*, 33 B.T.A. 478 and *Houston Farms Development Co. v. United States*, *supra*. In all of these cases the lessors un-

successfully sought to treat the receipt of payments as in the nature of depletable bonuses or advance royalties. In *Merillat v. Commissioner*, 9 B.T.A. 813, 'advance royalties and rentals' paid for the extension of a departmental oil and gas lease were held to be deductible expenses in the year in which they were paid." (At page 514).

POINT IV

THE RESPONDENTS WERE IN A TRADE OR BUSINESS INCIDENT TO THE OIL AND GAS LEASES AND THE RENTALS WERE DEDUCTIBLE UNDER SECTION 23 (a) (1) (A), BUT EVEN IF IT BE ASSUMED THAT THEY WERE NOT ENGAGED IN SUCH TRADE OR BUSINESS, THE RENTAL PAYMENTS ARE DEDUCTIBLE UNDER SECTION 23 (a) (2) OF THE INTERNAL REVENUE CODE OF 1939.

(a) Said rentals were paid for the purposes of Respondents' trade or business.

At pages 30-31 and 33-35 of the brief, the Petitioner presents an argument that the payments in question may not be deductible under Section 23 (a) (1) (A) of the Internal Revenue Code because, "At best, in so far as the record shows, the taxpayer, together with his partners, was engaged solely in a series of a few isolated transactions whereby he made investments in oil and gas leases, but this, needless to say, did not constitute carrying on a trade or business within the rule of the *Higgins* case, *supra*".

The aforesaid arguments on the part of the Petitioner are purely technical in nature and confuse the singular issue before the Court. The evidence is uncontroverted that the Respondents are and were, during the years herein involved, husband and wife and that the Respondent Robert H. Miller is a geologist and is and has been engaged

in various enterprises in the oil and gas field (R.24). These facts are admitted by the Petitioner at page 3 of his brief.

As concerns the requirements of Section 23 (a) (1) (A) that the expenses be paid or incurred during the taxable year in carrying on any "trade or business", reference is made to the following quotation in 4 Mertens, *Law of Federal Income Taxation* (1942) at page 310:

"It has been said that carrying on a trade or business involves 'holding one's self out to others as engaged in the selling of goods or services.'" *Deputy, et al Administrators v. Pierre S. Du Pont*, 308 U.S. 488 (1940), 84 L. Ed. 416, 60 S. Ct. 363. "In order that the taxpayer's activities may be characterized as trade or business it is not necessary that the taxpayer have a reasonable expectation of profit from the conduct of the enterprise. It is necessary, however, that the enterprise be initiated and conducted in good faith by the taxpayer with the intention of making a profit or of producing income. The factor of profit is only significant in so far as it affords a means of distinguishing between an enterprise conducted as a business and as a hobby.

The term 'business' is at least broader than the lay concept, in that it includes income from the professions and the arts as well as from ordinary commercial activities . . ."

Apparently the Petitioner is making the contention that deduction should be denied under Section 23 (a) (1) (A) because he claims the Respondents obtained an "equity" in the leases. It is submitted that the term "equity" as used in Section 23 (a) (1) (A) positively does not mean the interest ordinarily obtained by a lessee in securing a lease. Equity, as used in Section 23 (a) (1) (A) means a

beneficial interest or title in the property substantially equivalent to legal title. Typical applications of the meaning of the words "title" and "equity" in Section 23 (a) (1) (A) are involved in the numerous taxation cases dealing with purchases of chattels which are disguised as leases and wherein the purchase payments are denominated rentals, but are in fact deferred installment payments to acquire title.

For example, reference is made to the case of *Benton v. Commissioner*, 197 F. 2d 745 (5th Cir., 1952), wherein the court stated:

"If the parties in good faith actually intended to enter into a lease contract, then the taxpayer, up until the time that he exercised his option to purchase, acquired no title to or equity in the property. For the Commissioner and the Tax Court to decide solely by the application of an objective economic test that the taxpayer had an equity in the property, effectively begs the question to be decided, namely whether what was in form a lease was in substance and according to the real intention of the parties a conditional sale contract."

See also *Judson Mills*, 11 T. C. 25, wherein the taxpayer, a textile producer, acquired new mill machinery under agreements called leases whereby it was required to make fixed monthly payments called rentals to the machinery manufacturers for about five years and could then acquire title to the machinery by the payment of a relatively small additional amount. The Tax Court there held that the monthly amounts paid were not deductible as rentals because the taxpayer acquired an equity interest in the machinery.

If the term "equity" were to be used in the sense that the Petitioner contends, rentals relating to all leases would be denied deduction under Section 23 (a) (1) (A) because every lessee would have a so-called "equity" in the lease.

(b) Said rentals were ordinary and necessary expenses deductible under Section 23 (a) (2) of the Internal Revenue Code.

Section 23 (a) (2) was added to the Internal Revenue Code to avoid the type of argument advanced by the Petitioner and to permit an individual to deduct amounts spent in income producing activities or in managing and maintaining his investments even though he is not carrying on a business as such. See *Prentice-Hall, Federal Taxation Service, Vol. 2, 1955*, paragraph 12,003, at page 12,012, stating:

"Non-business rentals.—In addition to Sec. 162 (Paragraph 11,004) permitting the deduction of rentals as business expenses, Sec. 212 (paragraph 11,140-A) permits individuals to deduct 'all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income'."

In support of the above contentions, but at the same time without burdening the Court with the exhaustive authorities which exist, the following appears in 4 Mertens, *Law of Federal Income Taxation* (1953), *Cum. Pocket Supp.*, Section 25.118:

“The Revenue Act of 1942 added to existing deductions a new deduction to include non-trade or non-business expenses. In this respect ‘non-trade’ and ‘non-business’ must be understood as shorthand expressions referring to expenses unrelated to the usual or principal trade or business of the taxpayer, rather than to those which are wholly personal or non-commercial. This amendment was made only after long efforts to obtain statutory sanction for deduction of non-business and investment expenses. After much litigation on the subject the Supreme Court in *Higgins v. Comm.* (312 U.S. 212, 85 L. Ed. 783, 61 S. Ct. 475 (1941)) held that such expenses were not incurred in a ‘trade or business’ and therefore were not deductible. This decision set the stage for amendment of the law by the 1942 Act.

The change was made by Section 121 of the 1942 Act, which amends I.R.C., Sec. 23 (a) making the existing provisions thereof subparagraph ‘(1)’, and adding a new subparagraph ‘(2)’, which is as follows:

‘I.R.C., Sec. 23 (a) (2). Non-trade or Non-business Expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.’ ”

The Tenth Circuit had the issue here presented before it in the *Dougan* case, *supra*, and disposed of this technical argument as follows:

“We find it unnecessary to resolve the doubts concerning deductibility on either point, for we are convinced that these rental payments fall squarely within the provisions of Section 23 (a) (2) of the Code, as ordinary and necessary expenses paid or

incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income. See 4 Mertens, Law of Federal Income Taxation, 1953 Cum. Pocket Supp., Sec. 25.120, page 441."

In summary, the Respondents contend that the payments are clearly deductible under Section 23 of the Internal Revenue Code, such deduction being permitted under Section 23 (a) (1) (A) because the partnerships in question and the Respondents were in a trade or business incident to the oil and gas leases, but even if it be assumed that they were not, the payments are deductible under Section 23 (a) (2).

CONCLUSIONS

On the basis of the foregoing, it is concluded that Federal rentals on oil and gas leases, whether for the first or a later year, are true rentals and, therefore, deductible under Section 23 (a) (1) (A) of the Internal Revenue Code assuming the lessees are in the oil business or under Section 23 (a) (2) if the lessees are not in the oil business. This conclusion is based on the following general points, all of which have been discussed heretofore:

(a) The statutes, the lease forms and the regulations denominate these fixed periodic payments as "rentals".

(b) These payments are true rentals since they are fixed sums payable annually for the purpose of holding the possession of property.

(c) Congress clearly distinguished between the single, non-recurring payment denominated bonus and the annual payments involved herein denominated rentals.

(d) These annual advance rentals are identical with the payment required by any landlord who offers to rent to the first comer for rentals payable annually and in advance, such rental admittedly being deductible.

Respectfully submitted,

MAX B. LEWIS
HARLEY W. GUSTIN
FLOYD K. HASKELL
Attorneys for Respondents

No. 14737

United States
Court of Appeals
for the Ninth Circuit.

A. G. HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANNA HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

A. G. HOMANN,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ANNA HOMANN,

Respondent.

Transcript of Record

Petitions to Review Decisions of The Tax Court
of the United States

FILED

DEC - 3 1955

No. 14737

United States
Court of Appeals
for the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

A. G. HOMANN,

Respondent.

and

COMMISSIONER OF INTERNAL REVENUE,

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Transcript of Record

Petitions to Review Decisions of The Tax Court
of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

C. L. STICKNEY, ESQ.;

HARRY ELLSWORTH FOSTER, ESQ.

For Respondent:

JOHN O. DURKAN, ESQ.;

FRANCIS J. BUTLER, ESQ.

The Tax Court of the United States

Docket No. 37318

A. G. HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

* * *

1953

Oct. 21—Hearing had before Judge Oppen on the merits and oral motion of counsel to consolidate with Docket 37319, Granted. Stipulation of Facts filed; Briefs due 1/4/54; Replies due 2/19/54.

* * *

The Tax Court of the United States

Docket No. 37319

ANNA HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

* * *

1953

Oct. 21—Hearing had before Judge Oppen on the merits and oral motion of counsel to consolidate with Docket 37318, Granted. Stipulation of Facts filed; Briefs due Jan. 4, 1954, and Replies due Feb. 19, 1954.

[Title of Tax Court and Cause.]

Docket No. 37318

SECOND AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:90D:AAJ, dated July 27, 1951, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with principal office and residence at Lacey, Washington. The return for the period here involved was filed with the

collector for the district of Washington at Tacoma.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on July 27, 1951.

3. The deficiencies as determined by the Commissioner are in income taxes for the calendar year 1946 in the amount of \$10,148.95, of which approximately all of which is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

a. The additions to income of alleged unreported range and refrigerator sales in amount of \$3109.44, and miscellaneous Sunnyside income of \$2340.38.

b. The addition to income of additional gain on the sale of houses of \$15,793.12.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

a. The houses were all equipped with refrigerators and ranges. Some occupiers had either a refrigerator or a range, or both, and did not desire to purchase or rent unless these items were removed, in consequence of which many were removed and sold for salvage. The amount of additional income assessed from the salvage of the refrigerators is \$3109.44, which should be taxed at the capital gains rate rather than as ordinary income because the petitioner was never in the business of selling second-hand ranges and refrigerators.

b. The furnaces were defective and removed. Three hundred twenty-five dollars was realized from

this source on July 23, 1946, and on November 8, 1946, the sum of \$350.00, a total of \$675.00, one-half of which amount should be allocated to the petitioner but which should be taxed at the capital gains rate rather than as ordinary income because the petitioner was never in the business of selling second-hand furnaces. The difference between \$2340.38 less \$337.50, or \$2002.88, is properly taxable as ordinary income.

c. Gain on sale of houses was incorrectly reported as to amount as there was a realized loss of \$5342.35 instead of a taxable gain of \$10,025.49. The sale of houses held primarily for rent comes within the scope of section 117 (j) in which a loss would be deductible in full and a profit is to be treated as a long-term capital gain.

Wherefore the petitioner prays that this Court may hear the proceedings and redetermine the deficiency due from the petitioner for the year 1946.

/s/ HARRY ELLSWORTH
FOSTER,

/s/ C. L. STICKNEY,
Counsel for Petitioner.

Duly verified.

EXHIBIT A

Treasury Department
Internal Revenue Service
Securities Building
Seattle 1, Washington

July 27, 1951.

Office of
Internal Revenue Agent in Charge,
Seattle Division.

IT:90D:AAJ.

Mr. A. G. Homann,
Lacey, Washington.

Dear Mr. Homann:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1946, discloses a deficiency of \$10,-148.95 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle

1, Washington, for the attention of IT:90D:AAJ. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner;

By
Acting Internal Revenue
Agent in Charge.

Enclosures:

Statement

Form 1276

Form of waiver

AAJ:em

IT:90D:AAJ

Statement
Mr. A. G. Homann
Lacey, Washington

Tax Liability for the Taxable Year Ended December 31, 1946

	Deficiency
Income tax	\$10,148.95

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated October 1, 1948; to your protest dated November 2, 1948; and to the statements made at the conferences held on February 10, April 19, and June 7, 1949; May 18, October 12, and November 13, 1950, and May 21, 1951.

A copy of this letter and statement has been mailed to your

representative, Mr. C. L. Stickney, Security Building, Olympia, Washington, in accordance with the authority contained in the power of attorney executed by you.

Adjustment to Net Income

Net income as disclosed by return		\$15,669.80
Unallowable deductions and additional income:		
(a) Unreported range and refrigerator sales	\$ 3,109.44	
(b) Miscellaneous Sunnyside income	2,340.38	
(c) Gain on sale of houses	15,793.12	21,242.94
		<hr/>
Total		\$36,912.74
Nontaxable income and additional deductions:		
(d) Additional allowable depreciation		2,522.92
		<hr/>
Net income adjusted		\$34,389.82

Explanation of Adjustments

(a) Profit on sale of ranges and refrigerators in the Sunnyside housing project in the amount of \$6,218.88 was omitted in error from the community income reported in the returns of you and your wife, Anna Homann. Your community one-half of this amount is \$3,109.44.

(b) "Miscellaneous Sunnyside Income" in the amount of \$4,680.76 was omitted in error from the community income reported in the returns of you and your wife, Anna Homann. Your community one-half of this amount is \$2,340.38.

(c) It is held that the gain on sale of houses in the Sunnyside housing project reported in the community returns of you and your wife, Anna Homann, in the amount of \$10,025.49, was understated in the amount of \$31,586.23, of which your community one-half is \$15,793.12. The computation of reportable gain on the sale of these houses, as shown on the returns of you and your wife, is held to be incorrect in that:

(1) Depreciation allowed or allowable for 1945 and 1946 was not deducted from your basis in the houses sold.

(2) You deducted all of your remaining cost to December

31, 1946, in the housing project although your records show that two of the houses were sold in 1947 and not 1946.

(3) It is held that these houses were held primarily for sale in the ordinary course of your trade or business.

This adjustment of \$31,586.23 is computed as set forth below:

	Reported Per Returns	As Adjusted
Sale price of houses	\$453,659.98	\$453,659.98
Less: Expense of sales	18,310.75	18,310.75
Net amount realized on sales	\$435,349.23	\$435,349.23
Cost of houses sold	415,298.25	
Adjusted basis of houses sold		393,737.51*
Profit	\$ 20,050.98	\$ 41,611.72
Long-term capital gain, 50%	\$ 10,025.49	
As adjusted, ordinary income		\$ 41,611.72
Less: Profit reported		10,025.49
Understatement of profit		\$ 31,586.23
*Construction costs per return		\$415,298.25
Less: Cost of 2 houses sold in 1947	\$ 12,037.64	
Depreciation allowed or allowable, 1946 and 1945, on houses sold in 1946	9,523.10 †	21,560.74
		\$393,737.51
†Unadjusted basis of 69 houses and lots unsold at 12-31-45		\$415,298.25
Less: Costs not subject to depreciation:		
Land	\$19,453.86	
Cost of clearing title	6,146.93	
Trees, shrubbery and landscaping	2,713.99	\$ 28,314.78
Less: Non-depreciable cost of 16 houses sold in 1945 @ \$332.00 each	5,312.00	\$ 23,002.78

Reported
Per Returns As Adjusted

Basis, unadjusted, of 69 houses unsold at 12-31-45		\$392,295.47
Depreciation allowed on 69 houses in 1945 at 2½% per year, estimated at an average of 6 months after date of completion	\$ 4,903.69	
Less. Depreciation on 2 houses sold in 1947	142.14	\$ 4,761.55
Depreciation allowable in 1946, estimated at an average of 6 months from Jan. 1 to dates of sale		4,761.55
Depreciation allowable on houses sold in 1945		\$ 9,523.10

(d) Depreciation allowable in 1946 on Sunnyside housing project units, not claimed as deduction in the returns of you and your wife, Anna Homann, is computed as follows:

Depreciation on 69 houses at 2½% at an average of 6 months as shown above	\$4,903.69
Plus: Depreciation for an additional 6 months on 2 houses sold in 1947	142.14
Total depreciation allowable in 1946, not claimed	\$5,045.83

Your community one-half of this additional deduction is \$2,522.92.

Computation of Tax

Net income adjusted	\$34,389.82	
Minus: Excess of net long-term capital gain over net short-term capital loss		127.50
Ordinary net income	\$34,262.32	
Less: Exemptions	1,500.00	
Normal tax and surtax net income	\$32,762.32	
Tentative income tax on \$32,762.32		\$14,955.51
Less: 5% reduction		747.78
Partial Tax		\$14,207.73
Plus: 50% of excess of net long-term capi- tal gain over net short-term capital loss		63.75
Income tax liability		\$14,271.48
Income tax liability disclosed by return, Original Account No. 6300045		4,122.53
Deficiency in income tax		\$10,148.95

Lodged February 1, 1954.

Filed March 2, 1954, T.C.U.S.

[Title of Tax Court and Cause.]

ANSWER TO SECOND AMENDED PETITION

Comes Now the Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, and for answer to second amended petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the second amended petition.

2. Admits the allegations contained in paragraph 2 of the second amended petition.

3. Admits the allegations contained in paragraph 3 of the second amended petition.

4. Denies that he erred in his determination of the deficiency in income tax as shown by the notice of deficiency from which the appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph 4(a) and (b) of the second amended petition.

5. (a) Admits that the amount of additional income is \$3,109.44. Denies the remaining allegations contained in paragraph 5(a) of the second amended petition.

(b) Admits that \$2,002.88 is properly taxable as ordinary income. Denies the remaining allegations contained in paragraph 5(b) of the second amended petition.

(c) Denies the allegations contained in paragraph 5(c) of the second amended petition.

6. Denies generally and specifically each and every material allegation contained in the second amended petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that petitioner's appeal be denied and that the Commissioner's determination be approved.

/s/ DANIEL A. TAYLOR,

Chief Counsel, Internal Revenue Service.

Of Counsel:

MELVIN L. SEARS,

Regional Counsel;

FRANCIS J. BUTLER,

Attorney, Internal Revenue
Service.

Filed April 30, 1954, T.C.U.S.

Served May 3, 1954.

[Title of Tax Court and Cause.]

Docket Nos. 37318 and 37319

MEMORANDUM FINDINGS OF
FACT AND OPINION

Opper, Judge:

Respondent determined deficiencies in the income taxes of petitioners A. G. Homann and Anna Homann in the amounts of \$10,148.95 and \$10,457.70, respectively, for the taxable year 1946. The questions to be decided are (1) whether gain realized from the sale of certain houses during the year in controversy should be treated as capital gain rather than ordinary income; (2) if those houses were property used in a trade or business, whether their basis should be reduced by the amount of depreciation allowed or allowable thereon; and (3) whether petitioners omitted from their tax returns for the year in controversy certain gain realized

from the sale of furnaces, ranges and refrigerators. An amount received in connection with a construction contract is not now contested by petitioners as being taxable as ordinary income in the year 1946.

Findings of Fact

Some of the facts have been stipulated and are found accordingly.

A. G. Homann, hereinafter called petitioner, and Anna Homann, his wife, resided in Olympia, Washington, a community property state, at all times material herein. They filed separate income tax returns for the years 1945, 1946 and 1947 with the collector for the district of Washington.

Petitioner is a general contractor in Olympia, Washington. At the present time he maintains his office in Lacey, Washington, which is about 4 miles east of Olympia, Washington. Petitioner has been engaged in the general contracting business for 30 years, and is a member of the Associated General Contractors of America.

Petitioner's contracting business is conducted by him, individually, under the name of A. G. Homann, General Contractor. No one else has any proprietary interest in his business.

During World War II, petitioner worked on war projects. Some time prior to July, 1944, the Hanford Engineering Works, hereinafter sometimes called Hanford, requested that 100 single-dwelling homes be built to house 100 of its employees. Petitioner first learned about the proposed project from

some friends at the Seattle regional office of the Federal Housing Authority, hereinafter referred to as F. H. A. After finding out about the project, petitioner went to Sunnyside, Washington, and talked to a committee which had been formed to promote the construction of such houses.

After investigating what he had heard, petitioner agreed to proceed with the construction of the houses. In or about July, 1944, petitioner started construction on 85 single-dwelling houses in Sunnyside, Washington. Another contractor in Sunnyside built the remaining 15 houses desired by Hanford.

Petitioner constructed his houses on a tract of land which he purchased, replatted and recorded as Homann's Addition to Sunnyside. At least 100 lots were purchased. F. H. A. required that the lot for each house be not less than 60 feet wide. Petitioner's plat was submitted to F. H. A. and the houses were all approved by that agency. F. H. A. places a ceiling on borrowing in connection with its authorized projects.

When petitioner first learned about the project he was told that he could rent or sell only to Hanford employees. Early in the spring of 1945 Colonel Mathias, who was in charge of Hanford, advised petitioners' representative, Beckwith, without previous warning, that the Hanford employees were to be moved to Oak Ridge, Tennessee, and that henceforth there would be no Hanford employees available to occupy the houses.

None of the houses were ever rented or sold to Hanford employees.

The houses were completed in the spring of 1945. Lawns and shrubs were put in later when the ground was dry enough to work.

In order to finance this project, petitioner had borrowed about \$450,000 through Sherrill and Roberts, the lending agency for the project. Petitioner paid approximately \$20,000 for the land and his own investment in the project fluctuated between \$20,000 and \$60,000. The amount paid by petitioner for the land and the labor met the minimum requirements necessary to obtain this loan. In May, 1944, petitioner also borrowed \$45,000 from the National Bank of Commerce in Olympia, Washington.

The restrictions on renting and selling solely to the Hanford employees not being effective, petitioner conducted a radio campaign over Station KIT in Yakima, Washington. This program lasted for 2 months and consisted of spot announcements. It was handled by Beckwith and petitioner approved the plan. All of the houses were rented in 1945, before any sales were consummated.

Petitioner rented the houses on a month-to-month basis. There were no written leases. There were several oral agreements entered into whereby rent would be credited to the purchase price. These agreements amounted to a rental arrangement with an option to buy. All tenants who wanted to buy could have this arrangement.

F. H. A. restrictions through the latter part of 1945 allowed up to 20 per cent of its authorized

housing to be sold. The balance had to be rented. Sixteen of petitioner's houses, approximately 20 per cent, were sold in 1945. Sixty-eight of the houses were sold in 1946, after removal of all F. H. A. restrictions on percentage of sales. Only 1 house remained unsold at the end of 1946. This house, the one occupied by Beckwith as an officer, was sold in 1947, and a commission of \$300 was paid on the sale. All of the houses were sold to individuals. Each purchaser refinanced his purchase, and the proceeds of his mortgage were used to retire the original mortgage loan. Sales were negotiated continuously throughout the years material herein, beginning in April, 1945. The sales were closed in groups at irregular intervals because the lending agencies which refinanced the purchases would not process individual mortgage loans, but required petitioner to wait until a group could be accumulated.

At all times material herein, the houses were under rent control. This restriction did not change by reason of the removal of the Hanford plant and the elimination of restrictions on public rental.

Petitioner has never built any houses on his own account which were sold to others except the houses in controversy herein. He has never had a real estate broker's license. He had never previously built houses on his own account for rental purposes.

Horace Miller was a real estate agent in the town of Sunnyside during all years material herein, and served as petitioner's agent in the handling of money transactions. Miller was not the only real estate agent in Sunnyside. Miller was to get a 5 per

cent commission for collecting and transmitting rents to petitioner and a 2½ per cent commission on the sale of the houses. He always had authority to sell the houses if he found a buyer.

Miller took a deposit on the sale of a house in September, 1944. Miller had reason to believe that he was acting in petitioner's behalf.

Petitioner reported the gain realized on the sale of the 16 houses sold in 1945 as short-term capital gain. Petitioner had been in doubt as to whether those houses had been held for the 6 months necessary to qualify for capital gains treatment. Those houses were all sold to people who purchased without solicitation.

Sales of the 68 houses sold in 1946 were made to people who came in to purchase voluntarily. No "for sale" signs were ever displayed on any of the houses, and such advertisements were not carried in the newspaper.

The town of Sunnyside doubled in population during the period in controversy and petitioner's houses were selling without difficulty. At this time veterans of World War II were coming back and wanted homes. Most of the houses were sold to returning veterans. It was not necessary to put "for sale" signs up or to conduct a selling campaign.

Miller kept separate account of the income from rentals and the income from sales after August 1, 1945.

In 1945, petitioner had started the construction of a cannery building in Olympia on a fixed fee basis for the Midfield Packers, a co-partnership,

pursuant to an oral contract. The estimated cost of that building was in excess of \$200,000. Financial difficulties enveloped the Midfield Packers in the fall of 1945 at which time petitioner had invested between \$50,000 and \$60,000 in the building. Petitioners filed a lien and instituted suit to foreclose it. The building was only partially constructed at that time. A foreclosure decree was entered and appealed to the Supreme Court of the State of Washington. Judgment of foreclosure was entered September 9, 1949, and upheld on appeal March 9, 1951. Petitioner subsequently completed the building at an additional cost of approximately \$96,000.

At the time of the hearing herein, petitioner still owned this building. The first floor was rented to the Olympia Brewing Company at a monthly rental of \$1,250, and the upper floor was rented to the State of Washington at a monthly rental of \$450.

Petitioner did not know how much activity was carried on by Miller in selling his 85 houses. Petitioner's superintendent did not know how much sales activity was carried on by Miller.

Beckwith was employed by petitioner from 1941 until 1949 as an assistant and in this capacity he had charge of the houses and looked for prospective new business. He was the only employee retained permanently and he lived in one of the houses which served as his office. Beckwith received a weekly wage.

The houses were relatively new when they were sold and few repairs were necessary in order to improve the marketability.

After the houses were completed petitioner went to the project no more than once every 4 or 5 months.

The total cost of the 85 houses, according to the Sunnyside books, was \$515,539.82. Petitioner charged off \$94,133.57 on the 1945 income tax return and \$415,298.25 on the 1946 income tax return. On his 1946 income tax return, petitioner also charged off the amount of \$18,310.75 under the heading of expenses of sale and cost of improvements subsequent to acquisition.

In petitioner's 1945 individual income tax return the sales of the houses were listed under a schedule entitled short-term capital assets. Under the heading of "date acquired" the houses were listed as having been acquired July 1, 1945. Under the heading, "date sold," 15 of the houses were listed as having been sold September 1, 1945, and one house was listed as having been sold August 1, 1945. The respective gain on the sale of these houses in the amount of \$10,306.43 was included in income as net short-term capital gain. On a schedule attached to petitioner's 1945 income tax return the cost of the Sunnyside houses was shown at \$500,533.57 (84 houses at \$5,890 each and 1 house at \$5,773.57).

On petitioner's 1946 individual income tax return the gain on the sale of the 68 houses was included under long-term capital gains and losses with the date sold being listed as October through December, 1946.

In 1945, petitioner's income from rents was \$4,892.85. His income from sales of the houses was \$10,306.43. Rental expenses totaled \$9,606.53. Ex-

penses included interest, taxes, insurance and utilities, but nothing for depreciation or salary to Beckwith.

In 1946, the income from rents showed a loss of \$1,034.25. Repairs were deducted in the amount of \$14,828.98 and other expenses totaled \$2,454.36. Income from sales in that year was \$20,050.98.

The houses were originally equipped with refrigerators and ranges. Some occupiers owned their own refrigerators or ranges and did not desire to purchase or rent a house unless these items were removed. Many were removed and sold for salvage value. Petitioner realized \$6,218.88 from the salvage of the refrigerators. Petitioners were never in the business of selling second-hand ranges and refrigerators.

Some furnaces were defective and removed. \$325 was realized from their partial disposition on July 23, 1946. On November 8, 1946, the sum of \$350 was realized therefrom. Petitioners were never in the business of selling second-hand furnaces.

The houses which petitioner sold in the taxable year 1946 were held primarily for sale to customers in the ordinary course of petitioner's business.

Opinion

I.

Such elements as serve to distinguish *Mauldin v. Commissioner* (C. A. 10), 195 F. 2d 714, and *Rollingwood Corp. v. Commissioner* (C. A. 9), 190 F. 2d 263, on the one hand from *Victory Housing No. 2 v. Commissioner* (C. A. 10), 205 F. 2d 371, and

McGah v. Commissioner (C. A. 9), 210 F. 2d 769, on the other preponderate in requiring that the factual question, see *Rubino v. Commissioner* (C. A. 9), 186 F. 2d 304, certiorari denied 342 U. S. 814, be determined in respondent's favor. Our ultimate finding accordingly disposes of the primary issue.

Unlike the situation in *McGah v. Commissioner*, *supra*, the original purpose for which the houses in controversy were to be erected was frustrated before the operation really began. The evidence shows that petitioner could not have constructed the houses for rent to the employees of Hanford Engineering Works because the war plant in which they were to be employed had already been located elsewhere. On the contrary, even before it was built, one house was tentatively sold in 1944 from the plans. In the years 1945 and 1946 an almost uninterrupted succession of sales¹ took place; so that by the end of 1946 but one house remained and that was sold in the following year. Unlike Victory Housing none were retained for rental when restrictions expired. It is true that the houses were rented upon completion but the tenancies were from month-to-month and the evidence shows that some included an en-

¹Petitioner testified that his working capital was frozen in the fall of 1945 and that he could not obtain further bank credit. In spite of this he makes much of the fact that throughout the year 1946 his salable assets upon which all selling restrictions had been removed were not in any way being pressed as a source of capital funds. We find it so difficult to reconcile these two statements that we have omitted any finding of fact based upon them.

couragement to the tenant to purchase by not only conferring an option upon him to do so but providing for an application on the sales price of prior rental payments. See *Rollingwood Corp. v. Commissioner*, *supra*.

The evidence further shows not only that the great bulk of petitioner's income from this venture throughout its duration was from sales rather than rent but that at the level of rent being received no profit could be hoped for; the only means by which the venture was susceptible of final success was the sale of the units.

While it is true that petitioner made no direct advertising or promotional drive to dispose of these properties, the factor is neutral since the evidence shows that sales were taking place in the "seller's market" of the period without undue effort. *Mauldin v. Commissioner*, *supra*. And petitioner did employ a real estate agent who apparently was assured of sufficient business from the venture so that he agreed to accept a commission of only 2½ per cent instead of the usual 5 although it is not clear whether the commission was to be paid on all units sold or only on those in which the broker participated. In either event a considerable, continuous, and constant operation of sales apparently was envisaged.

Finally as we have already suggested, the number and continuity of the sales² make it almost impos-

²We have been unable to find the details of time and number of sales for lack of evidence. The conclusion, however, seems undisputed, and in any event petitioner cannot benefit by his failure to introduce more specific evidence.

sible by any recognized test to conclude that this was not a selling business. Although at one time restrictions were placed upon the number of sales, the implication is that as many sales were made as could be. And the methodical and systematic disposal of the entire development within virtually a 2-year period appears to us to call inescapably for the conclusion of fact set forth in our finding.

For the reasons stated we are satisfied that respondent properly charged petitioner with ordinary income rather than capital gain.

II.

By the same token, however, respondent erred in reducing petitioner's basis on account of depreciation "allowable." Since we have concluded that from the inception petitioner held the property primarily for sale it would not qualify for the "use in trade or business" requirement of the depreciation deduction. In fact, we do not read respondent's contentions as seriously opposing this view.

III.

Nor do we think the deficiency was proper in failing to include the basis of all but one of the houses in total cost. While one of the exhibits appears to show that 2 houses remained unsold at the end of the tax year other indications satisfy us that this was a typographical error and that only one house remained to be disposed of. We have so found.

IV.

In placing some of the properties in proper condition it apparently became necessary for petitioner to remove some furnaces, ranges and refrigerators. These were subsequently sold for their salvage value and respondent insists that this income also is ordinary income and not capital gain. We are unable to agree.

Whatever petitioner's business as builder, developer and seller of finished houses, he was clearly not in the business of selling used or secondhand equipment. These items were not held for sale in the ordinary course of petitioner's business.

Nor is there doubt as to the holding period. The evidence shows that the project was completed in early 1945. The sales in question took place in 1946. It follows that whatever equipment was included in the original properties must have been held more than 6 months when it was ultimately disposed of.

Decisions will be entered under Rule 50.

Received December 10, 1954.

Served December 20, 1954.

Filed December 20, 1954.

The Tax Court of the United States

Docket No. 37318

A. G. HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Respondent having on February 28, 1955, filed a recomputation of tax for entry of decision as in accordance with Memorandum Findings of Fact and Opinion of the Court, filed December 20, 1954, and petitioner having concurred therein, now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1946 in the amount of \$5,922.70.

[Seal] /s/ CLARENCE V. OPPER,
Judge.

Entered March 1, 1955.

Served March 2, 1955.

The Tax Court of the United States

Docket No. 37319

ANNA HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Respondent having on February 28, 1955, filed a recomputation of tax for entry of decision as in accordance with Memorandum Findings of Fact and Opinion of the Court, filed December 20, 1954, and petitioner having concurred therein, now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1946 in the amount of \$6,202.94.

[Seal] /s/ CLARENCE V. OPPER,
Judge.

Entered March 1, 1955.

Served March 2, 1955.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 37318

A. G. HOMANN,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

PETITION FOR REVIEW

Comes now A. G. Homann by his Counsel, Harry Ellsworth Foster, and petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered in the above cause on the 1st day of March, 1955, ordering and deciding that there is a deficiency in petitioner's federal income tax for the calendar year 1946 in the sum of \$5,922.70.

The tax return of the petitioner for 1946 was filed with the Commissioner of Internal Revenue for the District of Washington at Tacoma, Washington. The United States Court of Appeals for the Ninth Circuit is the Court of Appeals for the circuit in which said collector's office is located.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner.

Proof of service attached.

Received and filed March 31, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Docket No. 37318

NOTICE OF FILING PETITION
FOR REVIEW

To: Daniel A. Taylor, Chief Counsel, Internal Revenue Service, Internal Revenue Building, 12th and Constitution Avenue, Washington 25, D. C.

You are hereby notified that the petitioner, A. G. Homann, did, on the 28th day of March, 1955, send air mail, with air mail postage attached, to the Clerk of the United States Tax Court for filing a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause. That the said petition for review will be received by the Clerk of the United States Tax Court and filed in that office on the 30th day of March, 1955. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated at Olympia, Washington, this 28th day of March, 1955.

Respectfully,

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner.

Proof of Service

I hereby certify that I served the foregoing Notice of Filing Petition for Review on Daniel A. Taylor,

Chief Counsel for the Bureau of Internal Revenue, attorney for the Commissioner of Internal Revenue, Respondent on Review, by depositing a copy of the same in the Post Office at Olympia, Washington, with air mail postage prepaid, addressed to said attorney at his post office address, namely, Internal Revenue Building, 12th and Constitution Avenue, Washington 25, D. C., on March 28, 1955.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner on Review.

Received and filed March 31, 1955, T.C.U.S.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 37319

ANNA HOMANN,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

PETITION FOR REVIEW

Comes now Anna Homann by her counsel, Harry Ellsworth Foster, and petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States

entered in the above cause on the 1st day of March, 1955, ordering and deciding that there is a deficiency in petitioner's federal income tax for the calendar year 1946 in the sum of \$6,202.94.

The tax return of the petitioner for 1946 was filed with the Commissioner of Internal Revenue for the District of Washington at Tacoma, Washington. The United States Court of Appeals for the Ninth Circuit is the Court of Appeals for the circuit in which said collector's office is located.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner.

Proof of service attached.

Received and filed March 31, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Docket No. 37319

NOTICE OF FILING PETITION
FOR REVIEW

To: Daniel A. Taylor, Chief Counsel, Internal Revenue Service, Internal Revenue Building, 12th and Constitution Avenue, Washington 25, D. C.

You are hereby notified that the petitioner, Anna Homann, did, on the 28th day of March, 1955, send air mail, with air mail postage attached, to the Clerk of the United States Tax Court for filing a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax

Court of the United States heretofore rendered in the above-entitled cause. That the said petition for review will be received by the Clerk of the United States Tax Court and filed in that office on the 30th day of March, 1955. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated at Olympia, Washington, this 28th day of March, 1955.

Respectfully,

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner on Review.

Proof of Service

I hereby certify that I served the foregoing Notice of Filing Petition for Review on Daniel A. Taylor, Chief Counsel for the Bureau of Internal Revenue, attorney for the Commissioner of Internal Revenue, Respondent on Review, by depositing a copy of the same in the Post Office at Olympia, Washington, with air mail postage prepaid, addressed to said attorney at his post office address, namely, Internal Revenue Building, 12th and Constitution Avenue, Washington 25, D. C., on March 28, 1955.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner on Review.

Received and filed March 31, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Docket No. 37318

STATEMENT OF POINTS

The following are the points on which the petitioner intends to rely on review:

The Tax Court of the United States erred:

1. In holding that the petitioner's gain on sixty-eight houses was properly charged to him as ordinary income rather than capital gain.

2. In finding that the houses which the petitioner sold in the taxable year 1946 were held primarily for sale to customers in the ordinary course of the petitioner's business.

3. In failing to find that the petitioner was never engaged in the real estate business.

4. In failing to find that the insolvency in the fall of 1945 of the Midfield Packers froze petitioner's working capital and further bank credit was denied him, and that he was obliged to liquidate the sixty-eight houses in question in order to save the rental investment in the Olympia cannery building.

5. In failing to find that prior to the affirmance of the decree of foreclosure on the Olympia cannery building March 9, 1951, petitioner could neither borrow on the Olympia cannery building or sell it.

6. In failing to find that the sale of the sixty-eight houses in the calendar year 1946 was for the

purpose of liquidating one capital asset held for rental purposes in order to save a more desirable capital asset held for rental purposes and still held for rental purposes.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner on Re-
view.

Proof of service attached.

Received and filed March 31, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Docket No. 37319

STATEMENT OF POINTS

The following are the points on which the petitioner intends to rely on review:

The Tax Court of the United States erred:

1. In holding that the petitioner's gain on the sixty-eight houses was properly charged to her as ordinary income rather than capital gain.

2. In finding that the houses which the petitioner sold in the taxable year 1946 were held primarily for sale to customers in the ordinary course of the petitioner's business.

3. In failing to find that the petitioner was never engaged in the real estate business.

4. In failing to find that the insolvency in the fall of 1945 of the Midfield Packers froze peti-

tioner's working capital and further bank credit was denied her, and that she was obliged to liquidate the sixty-eight houses in question in order to save the rental investment in the Olympia cannery building.

5. In failing to find that prior to the affirmance of the decree of foreclosure on the Olympia cannery building March 9, 1951, petitioner could neither borrow on the Olympia cannery building or sell it.

6. In failing to find that the sale of the sixty-eight houses in the calendar year 1946 was for the purpose of liquidating one capital asset held for rental purposes in order to save a more desirable capital asset held for rental purposes and still held for rental purposes.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioner on Review.

Proof of service attached.

Received and filed March 31, 1955, T.C.U.S.

[Title of Tax Court and Cause.]

Docket Nos. 37318 and 37319

STIPULATIONS OF FACTS

It is hereby stipulated and agreed by and between the parties and their respective counsel that the following facts shall be taken as true subject, however, to the right of either party to introduce further evidence not inconsistent herewith.

1. The petitioners herein are husband and wife and at all times material hereto have resided at 112 No. Franklin in Olympia, Washington.

2. In the years 1945, 1946 and 1947 petitioners filed their income tax returns with the Collector of Internal Revenue for the District of Washington. Such income tax returns are attached hereto marked exhibits 1-A, 2-B, 3-C, 4-D, 5-E, and made a part hereof by reference.

3. On or about July of 1944, petitioners started construction on eighty-five single dwelling houses in Sunnyside, Washington. These houses were completed in the spring of 1945.

4. In 1945 petitioner sold 16 houses. In 1946 petitioner's claim to have sold 68 houses and in arriving at gain on the sale of the houses in 1946, petitioner has claimed the cost of the 68 houses. Petitioner now admits that one house remained unsold at the end of 1946. This house was located at 801 10th Street and was occupied by Mr. H. G. Beckwith.

5. The respondent herein contends that two houses were sold in 1947 and that their cost must not be used in computing the gain on the sale of houses in 1946. The Government's contention is partially predicated upon the following statement taken from a statement sent to petitioner by Horace L. Miller which was found in petitioner's records of a sale in 1947:

Sale of Lot 11, Block 4, Homann's Sub- division, 901 10th Street, Sunnyside, to Alma W. Hallstrom. Net price		\$6,500.00
7 months rent, Dec. 1st to July 1st, paid by Hallstrom at \$45.00 per month, 5% com- mission on rental	\$ 15.75	
Title insurance	52.50	
Pay off old mortgage as per figure given Miller by Art. Hamman of CH&H:		
Principal	\$5,069.96	
Interest 4-1 to 8-1	76.04	
Penalty	53.00	5,199.00
Check to balance	1,547.75	
	<hr/>	<hr/>
	\$6,815.00	\$6,815.00

6. The total cost of 85 houses per the Sunnyside books was \$515,539.82. Petitioner charged off \$94,-133.57 on the 1945 income tax return. On the 1946 income tax return the petitioner charged off \$415,-298.25.

The petitioner claimed no depreciation in either 1945 or 1946.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Petitioners.

/s/ KENNETH W. GEMMILL, W.H.P.
Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

Filed at hearing October 21, 1953, T.C.U.S.

In the Tax Court of the United States
Docket Nos. 37318 and 37319

A. G. HOMANN and ANNA HOMANN,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

TRANSCRIPT OF PROCEEDINGS

Wednesday, October 21, 1953

The above-entitled matter came on for hearing,
pursuant to notice to the parties, at 10:30 o'clock,
a.m.

Before: Honorable Clarence V. Oppen, J.,
Presiding.

Appearances:

HARRY ELLSWORTH FOSTER, ESQ.,
For the Petitioners.

FRANCIS J. BUTLER,
For the Respondent.

* * *

Mr. Foster: You agreed that the Sunnyside
books might be admitted in evidence and I ask that
the smaller volume be marked as petitioners' Ex-
hibit No. 1?

The Court: It will be received and marked as
petitioners' Exhibit No. 1.

(Petitioners' Exhibit No. 1 was marked for
identification.)

Mr. Foster: I ask that this record be marked as petitioners' Exhibit No. 2?

Mr. Butler: No objection.

The Court: It will be received and marked as petitioners' Exhibit No. 2.

(Petitioners' Exhibit No. 2 was marked for identification.)

Mr. Foster: I ask that there be marked as petitioners' [13*] Exhibit No. 3, the ledger sheets of Horace L. Miller, showing the house sales?

The Court: They may be received and marked Exhibit No. "3."

(Petitioners' Exhibit "3" is marked and received in evidence.)

Mr. Butler: I would request that petitioners make a statement for the purpose of introducing the rental records.

Mr. Foster: My principal purpose is to show that the rentals and sales were separately kept.

The Court: They may be received and marked as petitioners' Exhibit No. 4.

(Petitioners' Exhibit No. 4, marked and received in evidence.)

Mr. Foster: I ask that the escrow records of Horace L. Miller be marked and received, for the same purpose?

Mr. Butler: No objection.

The Court: They may be received and marked as petitioners' Exhibit No. 5.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Petitioners' Exhibit No. 5 is marked and received in evidence.)

Mr. Butler: The rental records and files of sales are kept in two different bound sheets of paper. Originally they started out, petitioners will admit, under the same [14] heading and subsequently there was a transfer which shows they were kept separately.

Mr. Foster: I am unable to answer that. Those I received myself a year ago from Horace L. Miller. He is a real estate man in Sunnyside and since this started has suffered a paralytic stroke and is incapacitated and could not carry on a coherent conversation. I don't know.

A. G. HOMANN

was called as a witness by and on behalf of the petitioners, and having been first duly sworn was examined and testified as follows:

The Clerk: State your name, please?

The Witness: A. G. Homann.

Direct Examination

By Mr. Foster:

Q. Your name, please?

A. A. G. Homann.

Q. Where do you reside?

A. Lacey, Washington.

Q. Where is that with reference to Olympia?

A. It is about four miles east of Olympia.

Q. What is your business?

(Testimony of A. G. Homann.)

A. General contracting.

Q. How long have you been so engaged?

A. For thirty years. [15]

Q. Under what name is your business conducted?

A. A. G. Homann, General Contractor.

Q. Is there anyone else interested in that business? A. No, there is not.

Q. When did you first come to Olympia?

A. In the fall of 1939.

Q. Has anyone else been interested in the business since that date? A. No, sir.

Q. Will you describe to the court the circumstances, in your own way, of this Sunnyside project coming to your notice?

A. During World War Two I engaged entirely in war work. I closed the office in Olympia and opened an office at McChord Field and put all my efforts into war efforts. It was requested by the Hanford Engineering Works that there be one hundred single dwelling homes built privately in Sunnyside to house one hundred of their employees and I was told that it was the most vital project to end the war we would have in the United States. Owing to that fact I decided to go and build the hundred houses. In Sunnyside there was a small builder that would like to have fifteen of the houses, so he built the fifteen and I built eight-five. I built these houses to rent to the employees of the Hanford Engineering—— [16]

Mr. Butler: I would prefer these questions to be

(Testimony of A. G. Homann.)

questions and answers. There are a lot of things going in which I don't feel are the best evidence.

Q. Was the existence of that project communicated to you orally or in writing?

A. It was communicated to me—one time I was over to Seattle to the F.H.A. and I knew some of them pretty well and they told me at that time that this was coming up and it might be something I would be interested in.

Q. What did you do with respect to that project? What was the first step?

A. I went to Sunnyside to investigate further in regard to what I heard.

Q. Approximately when was that?

A. Oh, I cannot tell exactly.

Q. Approximately?

A. I believe it was the middle part, a little before the middle part of 1944.

Q. Did you proceed with the construction of the houses? A. Yes.

Q. What tract of land, if any, did you buy for that project?

A. I bought several tracts of land and replatted and had it recorded as "Homann's Addition to Sunnyside." [17]

Q. At that time what was the population of Sunnyside?

A. Around twenty-five hundred.

Q. In area about how much land did you buy?

A. I bought——

Mr. Butler: Object. If he bought land I think

(Testimony of A. G. Homann.)

there would be documents or records that certainly would be the best evidence of it. Up to this time he was questioned if he had contracts and he didn't know. I insist to protect the government's interest if there is documentary evidence of this it is the best evidence.

Mr. Foster: It is purely preliminary.

A. I just wanted you to understand I bought land sufficient to erect eighty-five houses on.

The Court: It is part of this case or it is not.

Mr. Foster: I offer to prove by this witness now on the stand, that he purchased in 1944 a sufficient area of land on which he might construct eighty-five houses.

Mr. Butler: It is impossible for the government to know when he purchased the land or how much he purchased it for. That should be put in by documents.

Mr. Foster: The price in the documents would only show "Ten dollars and other consideration."

The Court: I sustain the objection. You have your offer of proof in. Go ahead.

Mr. Butler: As I told you in my opening statement [18] I assume there is some documentary evidence on a lot of this. I don't like to take objections all the time. If I could make an objection now and argue it in the brief——

The Court: If you want to make an objection make it when the question is asked and before it is answered. I will rule on it at that time.

Q. When did you start construction of these houses? A. Somewhere in July of 1944.

(Testimony of A. G. Homann.)

Q. When were they completed?

A. Early in the spring of 1945.

Q. How many did you build?

A. Eighty-five.

Q. What was the purpose of building the eighty-five houses?

A. To rent to the Hanford Engineering employees.

Q. Did you at any time receive any communication that you would be unable to rent to the Hanford Engineering employees?

A. I got a call from——

Q. You can answer yes or no.

A. Yes.

Q. Approximately when was it?

A. Early in 1945, to my knowledge.

Q. How was it communicated to you?

A. Over the 'phone by my representative in Sunnyside, [19] Mr. Beckwith.

Q. What was the communication?

A. That Colonel Mathias had come to our office in Sunnyside——

Mr. Butler: Object. It is hearsay if Mr. Beckwith received the communication and then told Mr. Homann about it. Mr. Beckwith might be able to testify to the conversation with the Colonel, but certainly not Mr. Homann.

Mr. Foster: I am asking this witness to tell what information he received on that job. He received the information from his employee on the project. Besides, Mr. Beckwith is here.

(Testimony of A. G. Homann.)

A. In 1945 I started to build a building, a can-
nery, [22] for the Midfield Packing Company. I
built it on a fixed-fee basis and everything went
swell until along toward the end, or the fall, of
1945, when some of their frozen products went bad
and they didn't get their money and consequently
they didn't pay me and I had between fifty and
sixty thousand dollars of my own money tied up in
that project.

Mr. Butler: I object at this point.

The Court: There is no question pending.

Mr. Butler: The question was asked when he
changed his mind. My point is he has gone beyond
that. It is not responsive.

The Court: Your procedure is to move to strike.

Mr. Butler: Yes, I am sorry. I move to strike.

The Court: What part?

Mr. Butler: The part relating to building the
building he mentioned and any matter pertaining to
financial losses or other financial receipts pertaining
to that building on the ground there should be other
documentary evidence which would be the best evi-
dence when that was started and the whole picture
of it.

The Court: I misunderstood you. I thought you
said he is now testifying to matters not responsive
to the question.

Mr. Butler: You suggested that the question had
not been asked. I say a question was asked and he
went [23] beyond the scope, and I also object to

(Testimony of A. G. Homann.)

what is coming out as not the best evidence of the transaction.

The Court: I am sorry but I cannot recall entirely what the matter was but if he has personal knowledge of the building being started then because he saw it with his own eyes, that is the best evidence. If you pinpoint what you say is objectionable.

Mr. Butler: The objectionable part is—he started the building. That is one thing. But he testified to finances, what he put in, how much he lost at one point, and I don't think his testimony is the best evidence.

The Court: Denied, and I suggest that after this you try to concentrate on the statement when it is made.

Q. When did you first start construction of the Midfield Building in Olympia?

A. April 7th, 1945.

Q. Was that contract oral or in writing?

A. It was an oral contract.

Q. What was the nature of the building?

A. It was built for a cannery, for processing frozen foods, or a cold storage cannery—whatever you want to call it.

Q. What was the agreed price of that building?

A. In excess of Two Hundred Thousand Dollars.

Q. What sort of a concern was the Midfield Packers, a [24] partnership, corporation or individual?

A. A partnership.

(Testimony of A. G. Homann.)

Q. Did that concern become involved in financial difficulties, and if so, when?

A. In the fall of 1945.

Q. When did you quit work on that building before the institution of the lien proceedings?

A. Less than ninety days before. We stopped it in the fall except enough to keep my lien alive, hoping they would pay. In the fall of 1945, I believe.

Q. And what did you do with respect to preserving your investment in that?

A. Filed a lien.

Q. Do you remember approximately when your lien was filed?

A. I looked it up and wrote it down in this little memorandum. If I can look at it—1946, I believe.

Q. You may refresh your recollection from any memorandum you have.

A. I don't have that. I started the foreclosure in November, 1946—when the lien was filed I cannot answer.

Q. When did you start your foreclosure?

A. In November, 1946.

Q. And for what amount?

A. A little less than Fifty Thousand Dollars, I [25] believe.

Mr. Butler: I move to strike. I don't think the witness is prepared to testify on these matters. He does not remember.

The Court: If you want to object to that the time to do that is when the question is asked. It was perfectly obvious what the answer would be.

(Testimony of A. G. Homann.)

Q. Did you complete that foreclosure?

A. Yes, sir.

Q. Who became the purchaser of the property at foreclosure sale? A. I did, myself.

Q. Do you remember when you acquired title to that Midfield Building?

A. In 1951—in March of 1951, I believe.

Q. At what stage of completion was the building when you acquired title to it by foreclosure?

A. Part of the foundation was in, the footings, and part of the outside wall where the steel trusses could be put on. That is the point where we quit work and where it was when I received title.

Q. Did you subsequently complete it?

A. Yes, sir.

Q. When, approximately?

A. I started work on it in 1952—no, no— [26] shortly after I received title. I have had it around two years.

Q. How much did it cost to complete construction of that building?

A. Around Ninety-six Thousand Dollars.

Q. Did you complete construction of the building? A. Yes, sir.

Q. Who owns the building now? A. I do.

Q. What use is made of the building?

A. The first floor is rented to the Olympia Brewing Company.

Q. At what rental? A. \$1,250 a month.

Q. Is any other portion of the building rented?

A. The upstairs part of the building that was

(Testimony of A. G. Homann.)

originally to be an office is rented to the State of Washington.

Q. At what rental? A. \$450 a month.

Q. When you changed your plan, your purpose, in holding the Sunnyside houses, what was the reason for your change?

A. Because I got into this mess with the Midfield Packers and my working capital was all tied up. I either had to liquidate or go out of business. The bank took my credit away from me and would not loan me any more and instructed me to pay back what I owed them. [27]

Q. In 1944 what was the extent of your bank indebtedness?

A. In May, 1944, I had \$45,000 borrowed from the National Bank of Commerce in Olympia.

Q. Prior to the time you acquired title by foreclosure to the Midfield Building in 1951 was it possible for you to either sell or borrow on the property?

A. I had nothing to sell or borrow on. It was merely a lawsuit that I hoped to receive title to.

Q. Who conducted that foreclosure for you?

A. Mr. Harry Ellsworth Foster.

Q. Did you ever have a real estate broker's license? A. No, sir.

Q. Were there written leases on the houses in Sunnyside, or under what circumstances were those houses rented?

A. They were rented month to month. There were no leases or signs on them.

(Testimony of A. G. Homann.)

Q. Did you ever extend to anyone an option to purchase any of the houses? A. No, sir.

Q. Did you ever make any changes in the houses to facilitate their sale?

A. There were never any changes to facilitate a sale. When a renter came in and went out we cleaned it out to make it ready for the next [28] renter.

Q. After the houses were completed what, if any, employee did you retain at Sunnyside?

A. I retained Harry Beckwith to represent me and listen to the complaints of the renters.

Q. Anyone else?

A. No; not in my employ. Horace Miller was the agent that handled the money for me and remitted the money to me.

Q. Who signed the deeds to the property?

A. Myself and my wife.

Q. Did anyone ever have any power of attorney to sign any deeds for you? A. No, sir.

The Court: We will take a ten-minute recess.

(Recess 11:11 a.m. to 11:21 a.m.)

Mr. Foster: If it please the Court, the decision of the supreme court in the Midfield case is in 38 Wash., 2nd, 1950; 228 Pac. Cir. 666.

The Court: Would counsel agree that is the proceeding to which the witness has been testifying?

Mr. Butler: Yes, your Honor.

Q. In addition to the building did that have any appurtenances? I refer particularly to a railway spur.

(Testimony of A. G. Homann.)

A. It had a railway spur coming in there in front of the building.

Q. That likewise was involved in the action? [29]

A. Yes, sir.

Q. And the judgment in that action was that it was spur to all of them? A. Yes.

Q. Now, will you describe to the court the circumstances about the furnaces? What was the matter with them?

A. The furnaces—it was a furnace that I was going to say was concocted in World War II to act as a furnace. It was not much more than a box stove that they burned coal in. It was not originally designed for coal and consequently would smoke and that would darken the paint in the room, as well as the furnishings in the house.

Q. From whom did you buy those furnaces?

A. I cannot tell you his name.

Mr. Foster: May I lead the witness?

Mr. Butler: I think this is immaterial. I don't have any objection.

Q. Was it the University Sheet Metal Works?

A. Yes.

Q. What disposition was made of the furnaces? What did you do with them, leave them in the houses or take them out?

A. We removed them from the houses and stacked them up along the alley and they were later sold to a junk man.

Q. Did any of those furnaces remain? [30]

A. Not to my knowledge, sir.

(Testimony of A. G. Homann.)

junk? A. No, sir.

Q. Do you remember as to whether or not you originally equipped the houses with ranges and refrigerators?

A. Yes, we did. We equipped each one with a range and a refrigerator.

Q. What was done with reference to the cost of those ranges and refrigerators with respect to the price of the houses for either rental or sale?

Mr. Butler: Object.

A. They were included in there.

Mr. Butler: Object, on the ground that this petitioner did not keep the books and I don't think he can testify from his own knowledge. Therefore, I don't think he is qualified to give this particular testimony.

Mr. Foster: Here is the owner of the houses and I am asking him with respect to the dealing with his own property.

Mr. Butler: I am sure they show how these were rented. I don't think the witness is qualified.

The Court: I think there is an ambiguity. Can you not withdraw the question and ask another? Do you mean as a bookkeeping matter?

Mr. Foster: Yes. [31]

Q. How were the prices of the houses computed with respect to the presence or absence of the range or refrigerator?

A. The house was priced with range and refrigerator.

Q. Did that apply to both sale and rental?

(Testimony of A. G. Homann.)

A. Yes.

Q. When the range or refrigerator, or both, was removed what happened to the original price you set on the property?

A. We deducted the amount of the range and refrigerator from it.

Q. Did you remove some ranges and refrigerators? A. Yes, sir.

Q. Under what circumstances and why?

A. Either the renter or the buyer had their own and would not wish to have ours in there.

Q. What disposition was made of those items after their removal?

A. We sold them secondhand to whoever might want to buy them.

Q. Were you ever or are you now engaged in the sale of such items? A. No, sir.

Q. Are you familiar with the street contract with the City of Sunnyside as reflected in one of these items, [32] "Sunnyside Miscellaneous Income"?

A. Yes.

Q. Explain.

A. This street was one of the main streets entering through the project and the Town of Sunnyside let a contract for this street to be improved. This contractor failed to fulfill the contract and that left us wallowing through mud trying to get to our project. We agreed with the city to go ahead and fulfill the contract so we could use the street to transfer our material and equipment in to our houses.

(Testimony of A. G. Homann.)

Q. Was that contract in writing or oral?

A. I believe it was oral other than we assumed the original contract.

Q. When did you finish that work?

A. In 1945.

Q. When were you paid for it?

A. I was not paid until 1946.

Q. On what system of accounting and reporting of income were you in 1944? A. Accruable.

Q. And were you in 1945 and 1946?

A. Yes, sir.

Q. And still are? A. Yes. [33]

Q. And always have been? A. Yes.

Q. Did you ever put any "For Sale" signs on these houses? A. No, sir.

Mr. Foster: That is all.

Cross-Examination

By Mr. Butler:

Q. I want to first go back to how this project originated. As I understand you found out about this project from the Hanford people?

A. I found out about it in the F.H.A. office in Seattle.

Q. Then you went up to Sunnyside?

A. I went up to Sunnyside and talked—they had a committee who were supposed to see they got the houses. I went with Ed Funk, the attorney for the city, over to the project and talked to Colonel Mathias.

(Testimony of A. G. Homann.)

Q. What were you told about the restrictions?

A. That I could only rent or sell—if an employee wanted to buy he had a right to, but I was restricted to the Hanford employees.

Q. You testified that you purchased the land?

A. Yes.

Q. As I understand, and correct me if I am wrong, you [34] borrowed money from the bank for this project?

A. I had from the bank at all times a loan running from twenty to eighty thousand dollars, depending on the amount of contracts I had. I never did get square with them for years.

Q. Is it not a fact when this project originated there was \$450,000—

A. Through Sherrill & Roberts, the lending agency for the project.

Q. And as your books show that was around \$450,000? A. Yes.

Q. During the time of this project, from the time you started it until the time you ended it your own investment would be approximately what, in the houses?

A. My own investment varied throughout. At the end of the project I had somewhere close to \$60,000.

Q. Is it not a fact that at the beginning of the project you had somewhere near \$20,000 in it?

A. The price of the land.

Q. Your own personal investment fluctuated be-

(Testimony of A. G. Homann.)

cause some of the houses were being sold and rented?

A. No; I bought the land and paid for labor and material up to the point where the houses could get a partial payment from the loan company.

Q. Were these houses built under the [35] F.H.A.? A. Yes.

Q. The F.H.A. guaranteed your loans up to around ninety per cent of the appraised value?

A. What do you mean, "guaranteed," or what do you mean?

Q. Did the F.H.A.—

A. They said how much we could borrow, yes.

Q. Did they guarantee up to about ninety per cent of the appraised value?

A. You say "guarantee." The F.H.A. didn't guarantee anything. They would allow us to borrow up to a certain amount if we could find a man to loan it.

Q. Do you have any documentary evidence in court on any of your dealings with the F.H.A.?

A. No, I don't.

Q. You signed some contracts with them?

A. We signed this house deal, yes.

Q. You don't have any documentary evidence?

A. I am sorry. There is none to be found. I will tell you where it is if you want to know.

Mr. Foster: I forgot something in the case in chief. May I interrupt? He moved and all records have been lost or destroyed.

Q. (By Mr. Butler): You don't know then

(Testimony of A. G. Homann.)

under what title of the F.H.A. [36] they were made?

A. I don't know. I would say 6 but I am not sure.

Q. You say Title 6?

A. I would not say but that is the only thing that comes to my mind.

Q. Did you have any written contract with the Hanford people? A. No, sir.

Q. It was all oral? Is that right?

A. Not entirely. All correspondence, etc., on the deal was handled through Ed Funk, city attorney, and I employed him as my attorney and paid him some twenty-five hundred dollars for so doing. He had all the correspondence in his office and after his term expired he left the office and I have not been able to find it since. He has a lot of valuable records of mine that would prove a lot of things I would like to find here.

Q. Did you make a search for Mr. Funk?

A. Yes; an extensive one.

Q. Did you go to his office in Olympia?

A. His office was in Sunnyside.

Q. Did you go to his former office?

A. Yes.

Q. And you were unable to find where he had gone?

A. The city attorney there then said Mr. Funk took [37] all records pertaining to this with him.

Q. Did you check with the attorney's records?

A. I just said I checked with the city attorney—I cannot give his name—and he said when Mr. Funk left he took all his records with him.

(Testimony of A. G. Homann.)

Q. When did you have this discussion?

A. At the start of the job and throughout the job.

Q. I am talking about recently.

A. No; I have not inquired recently.

Q. You had an agreement with the Hanford people to build these eighty-five houses?

A. That is right.

Q. The restrictions were you could only rent or sell to the Hanford people?

A. That is right. I don't think there was any mention of selling. We could rent to them but I assume if they wanted to buy——

Q. Do you know for sure that there was no mention of selling? A. I don't believe there was.

Q. Can you testify to this court—can you say for certain that there was no mention you could sell these houses?

A. If I could tell what is in my mind I would say yes, but I don't like to say. If I had these letters, etc., I [38] could say.

Q. These restrictions were lifted in 1944?

A. Either late in 1944 or early in the spring of 1945. I could not tell you which.

Q. You stated on direct examination that you had built these houses to rent or to sell to the employees of the Hanford project? A. Yes.

Q. And that before it was completed the restrictions were lifted and you then decided to continue with the building and you had a radio show, or a radio advertising program, for a period of two months. Now, in that radio program, or whatever

(Testimony of A. G. Homann.)

advertising was done on the radio, did you mention selling the houses? A. No, sir.

Q. What did you say?

A. We described the houses and where they were located and that they were for rent.

Q. You were under some renting restrictions at that time? A. That is right, as far as price.

Q. There is no change in those renting restrictions after the Hanford people decided to move out? You were still under restrictions?

A. Under rent control. [39]

Q. So it didn't make any difference who you rented to? If you rented to the employees from Hanford you would have gotten the same rent from the Hanford people as you got from other people? Is that not correct? A. That is right.

Q. Did you, at that time, when these restrictions were lifted and you had this radio program—did you employ Horace Miller to work for you?

A. No; not to work for me. I gave him the handling of the money that came from the rent or sale to remit to me.

Q. Is Mr. Miller a real estate agent?

A. Yes.

Q. Did you make an agreement with him to pay a certain percentage of everything he would sell?

A. I agreed he would have five per cent on the rent for collecting and sending me the money. Also on any sales made he would have two per cent—two and a half per cent.

(Testimony of A. G. Homann.)

Q. Is it not true that the usual fee for real estate agents for selling houses is five per cent?

A. That is true.

Q. Is it not true that you only gave him two and a half per cent and that Mr. Beckwith was also engaged there and you were going to give him two and a half per cent for the sale of each house?

A. No. [40]

Q. Didn't he get two and a half per cent?

A. No.

Q. He never got any commission?

A. No; only weekly wages.

Q. And you are saying he never received anything for his participation for the sales in the houses?

A. No, sir.

Q. You testified on direct examination that you didn't have any leases on these houses. Is that correct?

A. No written leases.

Q. But you did have agreements?

A. You would have to define what you mean by "agreements."

Q. You testified it was on a month-to-month basis?

A. That is right.

Q. Do you remember a conversation with me in my office concerning——

A. I think I know what you are referring to and will answer in my own way if you will let me.

Q. I will ask and then you can answer. You do remember a conversation in my office?

A. Several of them, sir.

(Testimony of A. G. Homann.)

Q. The one in particular pertaining to whether or not there were leases on this property?

A. I don't remember anything being said that there were leases on the property. [41]

Q. You don't remember telling me in my office that you didn't know whether there were any leases or not?

A. If there was any lease it was not given by me and no one else had power to do so. If there were any agreements—some of the renters came in and said at the time they rented if their job held out and they liked it here they would like to buy but didn't want to buy—you know when you come to a new country you kinda like to see what it is like, and some of them we told if they did want to buy we would carry the rent, that is, credit the rent to the purchase price of the house. That is the only thing we did down there that I remember. I knew what you wanted.

Q. Mr. Miller was hired right after you found that the Hanford people were not going to be available for occupancy?

A. That is right, sir.

Q. Did Mr. Miller have authority to sell some of these houses if he found a buyer?

A. There were some houses sold so there is not much doubt I told him not to.

Q. So we can infer from that that he did have permission to sell?

A. He did have permission to sell with my approval, yes, of the individual sales.

Q. Do you know of your own knowledge how

(Testimony of A. G. Homann.)

much activity [42] Mr. Miller pursued by way of selling these houses. Do you know of your own knowledge whether he posted signs or took ads in the paper, or had signs in his office?

A. There were no signs posted on the job and if there were any advertisements in the paper I have never seen them and I don't believe there was.

Q. You would not say there was not?

A. I would not say but I have never seen it or heard of it.

Q. But there is the probability that since he had permission to go ahead that he from time to time contacted clients of his own?

A. There were sales made. I don't know how he contacted them. The people came and tried to buy after they had lived there for some time and had employment there and things started to pick up. You could have sold them a dozen times.

Q. You say you are in the general contracting business and have been in it for thirty years?

A. Yes.

Q. You built buildings before you built these houses?

A. I built many buildings.

Q. And did you sell them?

A. No, sir.

Q. You never built a building that you [43] sold?

A. Yes; I built a home for myself that was sold.

Q. How did you handle these construction contracts? Did you contract with someone and build a house or building and then they would sell it?

(Testimony of A. G. Homann.)

A. As far as house building is concerned, since 1926 I have never built no houses.

Q. I am talking about buildings you built.

A. Most of my work is done by bidding on a job with other competitive builders and when I am low builder I build on contract. That is ninety-nine per cent of my jobs.

Q. You build on contract for another builder?

A. No, for the owner.

Q. What associations do you belong to?

A. Associated General Contractors of America, Tacoma Chapter.

Q. Any others?

A. Not in the building line. I belong to other things but not in the building line.

Q. We were talking earlier of this F.H.A. so-called Title 6. Did that impose any restrictions on you as to selling or renting the property?

A. I am not saying it is Title 6—I don't know. They had so many titles during the war and there were so many different projects. Most of them, I think, allow [44] up to twenty per cent sale and the balance can be rented.

Q. Had all the houses been completed by the time you found the Hanford people would not be available? A. Yes, sir.

Q. They had all been completed?

A. The houses, yes, but we put in the lawns and trees, and shrubs, etc. That came in the spring after it was dry enough to work the ground, etc.

Q. Do you know of your own knowledge and for

(Testimony of A. G. Homann.)

sure whether the F.H.A. fixes the location and size of the house and the type and number of the rooms?

A. When you have a F.H.A. project you submit a plat, showing the site of the land and the location. They inspect it. You submit a plat of the house and they approve or disapprove it. If they approve you build it and if they don't approve you don't build it.

Q. These were all single dwellings?

A. Yes, and all approved.

Q. From the time you completed the houses until they were all sold is it not true the cost of maintenance and upkeep were rising swiftly and it was costing you more to keep the houses, per house?

A. Nothing during the time of owning the houses was raised. I had one man employed. He took care of it. I didn't pay any more wages. It might be a gallon of paint [45] cost a little bit more, but it was a very small amount.

Q. How long would you say this radio campaign was conducted?

A. I paid two different months for it so it was two months at the same amount.

Q. Who handled it for you?

A. Harry Beckwith.

Q. Did you approve the plan? A. Yes.

Q. You testified that all the houses were rented before any were sold. Is that a correct statement? Refresh your memory?

A. I don't have to look at the record. I have nothing here to refresh on.

Q. Was any effort made at all on your part, or

(Testimony of A. G. Homann.)

on the part of any of your agents, including Mr. Beckwith, to keep the houses in constant repair? You fixed them up from time to time?

A. The only thing done in repairing the houses was if kids would dirty up the walls and smear them up and then we would give them another coat of paint and clean them up.

Q. You testified on direct examination that you did nothing to improve the marketability of the houses?

A. No more than after renting a house if one renter goes out and another comes in. You always do that. [46]

Q. That is what I am getting at. Since they were new houses and were fairly new all along, there was not much to do?

A. No maintenance except once in awhile the kids would dirty up the walls and we would clean it and paint it up again.

Q. What were Mr. Beckwith's duties there?

A. Looking after my interest in these homes.

Q. Do you know how much activity he conducted on behalf of selling these houses? Do you know that of your own knowledge?

A. No, sir.

Q. You testified about the furnaces. These were the original furnaces that were installed in the houses?

A. The ones in there that we took out?

Q. Yes. A. Yes, the originals.

Q. You took these out and put new ones in?

(Testimony of A. G. Homann.)

A. We took them out and put in oil burning furnaces.

Q. With regard to this street contract, as I understand, you actually took this work over and performed it in the year 1945? A. That is right.

Q. The contract itself was on a street that had bogged down your project? [47]

A. It was a street that the City of Sunnyside had let to improve and during the course of the improvement they had cut the top off and left the mud. We could not get through with our trucks and equipment. When he threw it up we agreed with the city that we would complete the contract for the amount of money he had left.

Q. When did you agree with the city on that?

A. I imagine a couple months before that was inspected.

Q. When was that inspected? I will refresh your memory. Was it October 10th, 1945?

A. I believe that was right. It was within a day or so of the time we completed it.

Q. Did they tell you at that time that you would be recompensated for that?

A. This contractor had quit and my office informed me that the road was impassable. I went up there and went with Harry Beckwith and Ray Lensen to the street commissioner and told them the shape we were in. They told me there was no money left to pay for it in the year 1945 so there was nothing he could do until their new appropriation came in. The money was all spent. We told them we

(Testimony of A. G. Homann.)

simply could not continue our project, could not get our supplies in with that kind of a street, so they said, "You fix the street and we will pay you." So we finally agreed that we would go ahead and finish it out and as soon as the [48] appropriation came in they would pay me, which they did.

Q. That was in '45, or was it '46?

A. No, in '45.

Mr. Foster: It was paid in 1946.

Q. Was it agreed on at the time you talked to these people how much you would receive for this street contract?

A. As far as them paying me it would be just the balance that they would have had to pay the other contractor if he had completed it.

Q. So the amount was not agreed on until after the job was completed?

A. No, the amount was agreed on according to the other man's contract.

Q. Will you give that again?

A. We agreed to do it at so much per yard for unit excavation, so much for base rock, and so much for sand rock that went on top of the surfacing.

Q. You testified that you built these houses for the occupancy of the people from the Hanford project and that you expected to rent to them, that your rent would be under the rent ceiling of some kind, rent restrictions. Then you testified that this changed. You found that the people were not going to be available for renting and you said your purpose changed. Is that correct?

(Testimony of A. G. Homann.)

A. The purpose—I don't know what you mean by "purpose." [49]

Q. Well, your purpose in building was to rent?

A. We built for the Hanford Engineering Works.

Q. Didn't you testify on direct examination that your purpose changed?

A. Well, the original intention changed because there was no more Hanford Engineering Works to deal with.

Q. What did it change to?

A. Well, it forced us to go out and find who we could to rent to.

Q. And how about to buy?

A. Well, it just seemed it changed from renting to buying when I got all my capital tied up on these two projects.

Q. When was this? A. Early in 1946.

Q. How many houses did you sell in 1946?

A. Sixteen.

Q. Then you had some intent to sell the houses in 1945?

A. Some of these people came in to rent and said they wanted to buy rather than rent.

Q. So you sold in 1945?

A. Sixteen houses.

Q. Did you sell any in 1944? A. No.

Q. Did you take any earnest money in 1944? [50]

A. In 1944 they had taken one deposit which we were told by the Hanford Engineering Works we could not do and so it did not go through.

(Testimony of A. G. Homann.)

Q. So you took one deposit?

A. I didn't take it myself. It was taken over there.

Q. Where? A. In Sunnyside.

Q. By whom?

A. Horace Miller. Any real estate man might take a deposit and ask if I would sell. That is what real estate men are in business for. They even try to buy property now that I don't want to sell.

Q. Did Horace Miller contact you about this house?

A. Either me or Mr. Beckwith. I could not tell you which way it was.

Q. Did you tell him to take a down payment?

A. No, I didn't.

Q. But he took it? A. Yes.

Q. Do you mean they merely took the down payment without consulting you at all?

A. If you are in the real estate business you know it is done time and time again. A person wants to buy a particular piece of property and I go see the owner——

Q. You mean I go uptown to a real estate agent and tell [51] him I want to buy the Federal Court House and I put down five dollars and he says "I will take the five dollars"?

A. I have gone myself and told them I want to buy such and such a piece of property, and tell how much I want to pay for it. He will go to the owner.

(Testimony of A. G. Homann.)

Q. Had you ever talked to Horace Miller before he took that down payment?

A. I have talked to Horace Miller many times.

Q. You talked to him apparently in 1944?

A. I talked to him before I ever started the project. He was one of the directors in the getting of these houses.

Q. Is he the only real estate agent in Sunnyside?

A. No, there are many of them.

Q. Had you told him he might act in your behalf in 1944?

A. When I talked to him I told him that when the project was over and rented and completed I had to have someone represent me and send the money to me and that I wanted him to do that when the time came.

Q. So he had reason to believe that he was acting on your behalf? Is that a correct statement?

A. I imagine he had reason to believe he would be the one to act for me and on my behalf if anyone could.

Q. When is the first day you found out the Hanford people would not be available? [52]

A. I testified that it was either late in 1944 or early in 1945 and that is the best I can tell you, sir.

Q. You don't know the exact date?

A. No.

Q. The people who bought their houses in 1945 were under a so-called option to buy? You had an agreement with them if they paid their rent and

(Testimony of A. G. Homann.)

subsequently wanted to buy the house you would take the rent and apply it on the purchase price?

A. Not unless the people came to me and wanted to buy.

Q. But you did have some of these agreements?

A. A few, like I told you, if they were renting and wanted to buy.

Q. Can you testify from your own recollection how many of your houses were sold before they were rented?

A. I could not testify that there were any.

Q. Is it not a fact that some of the houses were never rented?

A. Well, I would have to look at the record to find that out. I could not tell you here. I carry on a large business and ninety-nine per cent of my time is taken up in my contract jobs and that is like many other things. However, Harry Beckwith is over there to represent me and after the construction part was done I very seldom went over there or gave it much thought. [53]

Q. You didn't pay too much attention to it? It was all in Mr. Beckwith's hands?

A. After the project was completed and we decided to go ahead and rent the houses, that is right. I was busy making money to keep the operation going.

Q. Did you go over there occasionally, to the houses? A. Yes.

Q. How often did you go?

(Testimony of A. G. Homann.)

A. Well, during construction I went over, I believe, every week.

Q. After the houses were completed?

A. I doubt if I got over there once in four months.

Q. Then how could you testify that there were not any "For Sale" signs on the property?

A. I didn't see any "For Sale" signs and I never paid for any.

Q. You don't know then from your own knowledge how much activity Mr. Beckwith conducted?

A. I am sure Mr. Beckwith would not disregard my orders not to put up "For Sale" signs.

Q. Did you give him orders not to?

A. Yes.

Q. What was the reason for that?

A. I didn't want them there.

Q. Why didn't you want them there? [54]

A. When I started the thing we were only going to rent and after I got in they would still be rented.

Q. You sold sixteen houses in 1945?

A. Yes.

Q. At that time you decided to sell the houses?

A. That is right. People came there and wanted places. They have to live there and have their jobs there. What are you going to do, say "No, I won't give it to you"?

Q. Why not put up for sale signs?

A. Because I didn't have enough for general sale.

(Testimony of A. G. Homann.)

Q. You told Mr. Beckwith not to put up "For Sale" signs? A. That is right.

Q. When did you tell him that?

A. Right at the start.

Q. At the beginning?

A. Yes, when the houses were finished.

Q. But you don't know of your own knowledge, if you only visited the houses once in four months or so—you don't know of your own knowledge there were not some of those signs around the houses from time to time?

A. I told you I didn't authorize any, I never seen any, and I don't believe there ever was any. Mr. Beckwith can answer that question.

Q. Do you know of your own knowledge, Mr. Homann, how [55] you reported the income tax from the sales in 1945?

A. I paid one hundred per cent——

Mr. Foster: The income tax returns are in evidence.

A. I can answer your question another way. My understanding is that on a long-time gain you have to hold your property six months or longer before you can take that and these first houses were on the margin where there might be some question where it might be over six months. That is why there is no capital gain in 1945.

Q. I show you your individual tax return and ask you who made that out?

A. Frank Kinsey.

Q. Did Mr. Kinsey make out all your income tax returns? A. He did at that time, yes.

(Testimony of A. G. Homann.)

Q. Did you have a discussion with Mr. Kinsey as to how to incorporate these houses in any of the years? A. Well——

Q. How they were to be handled on the income tax return?

A. You mean on the second year sales?

Q. On all the sales.

A. I never gave any account how to do anything except what the books showed and the facts were.

Q. Did you have any discussion with Mr. Kinsey concerning these income tax returns? [56]

A. I don't know what you mean.

Q. Did he call you down when you signed the returns and talk to you about them?

A. He showed me the income tax returns.

Q. Did you have considerable confidence in him?

A. I had considerable confidence in the court at that time.

Q. Did you think he would incorporate everything you should pay?

A. That is right. I always insisted if there was any question that I would rather pay more than not enough. I always said "Whatever you do, don't make it short."

Q. I have here the 1946 income tax return of your wife, Mrs. Homann. As I understand, these returns were all made by Mr. Kinsey and you have testified you had a lot of confidence in him and never questioned him. I am going to ask you if Betty Griggs was claimed as a dependent on your 1946 income tax return? A. Yes.

(Testimony of A. G. Homann.)

Q. And that she was adopted——

A. I don't know how that got there.

Q. That is Exhibits 2b and 3c. Was she adopted?

A. No.

Q. Is Homann her name? A. No. [57]

Mr. Butler: I have no further questions.

A. I would have liked to answer him.

Mr. Butler: I would like to keep the record straight.

A. I have taken nine kids and put them through high school and gave them an education and put them out in the world and got them jobs, and the way that came about is Mr. Kinsey said "You should be entitled to her as a dependent." I have had nine kids and still have them and have some coming. I do that instead of going to church.

Mr. Butler: I didn't have any other purpose except to bring out that the man who handled your income tax reports was rather shady in the way he handled the thing. Believe me, Mr. Homann, that was my only purpose. If the government had for one moment thought you had taken that claimed dependent without disclosing the facts they would have claimed fraud but they don't think that.

The Witness: Mr. Kinsey would still be with me if I had not found out he made too many notations and didn't do as he was paid to do. He kept the records in Tacoma and I never got to see them.

Redirect Examination

By Mr. Foster:

Q. When did you release Mr. Kinsey?

(Testimony of A. G. Homann.)

A. When I went to Tacoma to get the books he was [58] supposed to make on Sunnyside and found he had not done so, that he had promised month after month, and at that time I employed Mr. Stickney as my accountant.

Q. Where was your office in 1945, 1946 and 1947?

A. 112 North Franklin.

Q. Olympia? A. Yes.

Q. Is it there now? A. No.

Q. Where is it now?

A. Lacey, Washington.

Q. When did you move it?

A. About 1949, I believe, sir.

Q. Have you looked for additional records in this case? A. Yes.

Q. Have you been able to find them?

A. No, sir.

Q. Did you give Mr. Kinsey any records that you do not now have?

A. I gave Mr. Kinsey many records that he at that time had on this particular project.

Q. Were you able to get them back?

A. Not all of them.

Q. Are you able to describe those that are missing?

A. The individual cards that gave a complete description [59] of each and every one of these houses. It was prepared by Mr. Miller.

Q. When did you last see Mr. Miller, Mr. Horace L. Miller?

A. It seems to me about a year ago.

(Testimony of A. G. Homann.)

Q. And under what circumstances?

A. We went there to see him to see if he had duplicates of the cards he had given me that were given to Mr. Kinsey.

Q. Who went with you on that occasion?

A. Mr. Harry Ellsworth Foster and Mr. Stickney.

Q. What was Mr. Miller's physical condition?

A. He had had a stroke of paralysis. He could not walk and was barely able to talk.

Q. Was he able to testify orally or by deposition?
A. I would say not, sir.

Q. Was he able to carry on a coherent conversation?
A. No, sir.

Q. Has his condition changed any recently?

A. I have not seen him since but hear he is worse.

Q. When you started this project how much land did you buy?

A. We made eighty-five lots out of it. I imagine we bought one hundred lots, at least. The F.H.A. requirements were that they be not less than sixty feet wide.

Q. Who is Ed Funk? [60]

A. He was city attorney of Sunnyside and head of this committee who were getting the houses for Sunnyside. I employed him at that time as my attorney to take care of the correspondence with the Hanford Engineering Works and any other correspondence I wanted taken care of.

Q. Do you know where he is now?

(Testimony of A. G. Homann.)

A. I do not, sir.

Q. When did he cease to be in your employ?

A. About the time the houses were finished.

Q. After that was there some litigation between you? A. Yes.

Q. Do you know where he is now?

A. No, sir.

Mr. Butler: I object to this line of questioning.

Mr. Foster: I want to show that this witness is not available.

The Court: It is repetitions. He already testified to it.

Mr. Foster: Very well, I will withdraw it.

Q. The earnest money that was received in 1944, Mr. Homann, that Mr. Butler characterized as a "down payment," was that returned or did you keep it?

A. To the best of my knowledge it was returned.

Mr. Butler: I move to strike. If he doesn't remember I don't think it should be in the record. He [61] would have to show he would have that knowledge and I don't believe he has and I will move to strike.

The Court: It will be stricken.

Q. Have you ever, since these houses were built, or before that, built any houses for sale on your own account? A. No, sir.

Q. In the year 1946 what was your purpose in renting these houses?

A. The contracting business is a very uncertain business and I have a large family that I work hard

(Testimony of A. G. Homann.)

to support and I am always looking for some place to get an income with which to support that family in case of my death, and that is the reason why I wanted to keep the houses, for that purpose.

Mr. Foster: That is all.

Mr. Butler: I have no further questions.

The Court: I have one or two questions.

Q. I understood you to say you had instructed Mr. Beckwith not to put any "For Sale" signs on the property? A. That is right.

Q. I also understood you to say that probably this man, Miller, or his organization, took a down payment, or earnest money payment, on one house the year before?

A. Well, honestly, between you and I, I cannot tell you much about it but I do know that someone tried to buy and we [62] were not to rent to anyone except Hanford employees and I know it didn't go through.

Q. I understood you to say a real estate agent might come in voluntarily in a situation like that even without being instructed?

A. That is right.

Q. Have you any way of knowing whether or not Mr. Miller put any "For Sale" signs on that property when you were not there?

A. I have never seen any sign on the property when I went there.

Q. I understood you to say there was a period of as much as four months when you were not there?

A. I think between the time the houses were completed and the final deal made there might have

(Testimony of A. G. Homann.)

been as much as three or four months when I may not have seen it.

The Court: I have nothing further.

Mr. Butler: I would like to ask a further question, if I may.

Q. Mr. Homann, it is true, is it not, that after these houses were completed you didn't have any trouble renting them? They were all rented?

A. At the start there was, but there was a lot of shortage of houses in the Yakima Valley and that is the reason we put the advertising program on. [63]

Q. But that was the first two months when you found that the Hanford people were not available?

A. When we found it would be hopeless if we didn't do something.

Q. When you found the Hanford people would not be available you contacted the radio?

A. That is right.

Q. After that you had no trouble renting the houses? A. I had them all full.

Q. There would be no reason for having "For Sale" signs on them? A. I guess not.

Mr. Butler: That is all.

Redirect Examination

By Mr. Foster:

Q. Did you ever see a rented house with a "For Sale" sign on it? A. I don't—

Mr. Foster: I will withdraw that question.

(Court adjourned 12:20 p.m., October 21, 1953.)

October 21, 1953—2:00 P.M.

HARRY G. BECKWITH

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified [64] as follows:

The Clerk: State your name, please.

The Witness: Harry G. Beckwith.

Direct Examination

By Mr. Foster:

Q. Mr. Beckwith, where do you live?

A. Sunnyside, Washington.

Q. Are you employed by the petitioner, Mr. A. Homann?

A. No, sir.

Q. Were you employed at one time by him?

A. I was employed in 1941 until about 1949—I guess eight or nine years.

Q. Since then have you been employed by him?

A. No.

Q. In what capacity were you employed by Mr. Homann?

A. Well, as assistant in helping—assistant in McChord Field, and in Sunnyside it was in charge of these houses. He was a long way away and I had charge of these houses and also I was looking after new business there, to acquire new business.

Q. When were the houses completed?

A. 1945.

(Testimony of Harry G. Beckwith.)

Q. Can you tell us approximately when?

A. No, it would be toward the end of the year.

Q. When was the change made with respect to the Hanford [65] occupying these houses?

A. It was late in 1944 or early in 1945.

Q. How was that change communicated to you?

A. Colonel Mathias came down in uniform and said, "Well, boys, the project is yours. We don't need it anymore."

Q. What else was said?

A. "The people we expected to come here we are moving to Oake Ridge, Tennessee."

Q. Were they moved?

A. The next Sunday night. A car came along and moved them out. They were living in the federal project up in Sunnyside.

Q. How did the radio program on the radio start?

A. Well——

Q. When did it start?

A. Along about June or July, 1945.

Q. Who had charge of that advertising?

A. I did.

Q. Will you describe it to the court?

A. It simply described the houses and the availability of the houses for rent in that district. With the Hanford project out of the way we didn't know where we were going to get anyone to rent because in moving the Hanford people out of the community perhaps the whole thing was going to be moved. The army does that many times. [66]

Q. What radio was that?

(Testimony of Harry G. Beckwith.)

A. KIT, Yakima.

Q. Did they have a name for the announcement of the program you carried on that radio?

A. Did they have a name?

Q. Yes. A. I don't understand.

Q. What was the name of it? Did you have a program?

A. It was just a spot announcement.

Q. During what months did the spot announcement appear on the radio station?

A. I would say June, July, and possibly August, 1945.

Q. What was the response to it?

A. It was very good. It saved our lives, in fact.

Q. Was that ever renewed? A. No.

Q. Did you ever have any radio campaign to sell those houses, or any advertising campaign for that purpose? A. No.

Q. Did you ever display any "For Sale" signs on the houses? A. No.

Q. Do you know whether or not Mr. Miller carried any newspaper advertisements on them?

A. I don't recollect any newspaper advertising being [67] carried there. I didn't need to because the G.I.'s were coming along about that time and beginning to inquire about their ability to get in the houses.

Mr. Butler: I move to strike because it is not responsive and also because he says he thinks. He didn't seem to have any first-hand knowledge. It may be he didn't see any but the inference is Mr.

(Testimony of Harry G. Beckwith.)

Miller didn't conduct any campaign, but I don't think the witness can say for sure.

The Court: I will deny the motion.

Q. When did you last see Mr. Miller?

A. About two weeks ago.

Q. What is his present condition?

A. Very poor.

Q. Is he able to testify?

A. No, his memory is bad and it is with great difficulty that he moves about at all.

Q. How were the houses, the sales of the sixteen houses in 1945 made? Was that in response to anything in particular?

A. No, it was just a gradual dropping in of people who wanted to get houses.

Q. Volunteers? A. Volunteers.

Q. Did you occupy one house, one of these eighty-five [68] houses?

A. Yes, I occupied 901 - 10th Street—it was 801 10th.

Q. Was that house sold?

A. That house was sold.

Q. When? A. In 1947.

Q. At the end of the calendar year of 1946 how many houses remained unsold?

A. The one I lived in.

Mr. Butler: Objection. That is not reflected in the stipulated facts. The stipulation was that 801 remained and that 901 was sold.

Mr. Foster: Mr. Butler, we went over that very carefully.

(Testimony of Harry G. Beckwith.)

Mr. Butler: There is nothing in the record so far to show that is a resale. That is up to you. Our record shows the house was sold in 1947.

Mr. Foster: May I have the stipulation? On the second page. "In 1945 petitioner sold 16 houses. In 1946 petitioners claim to have sold 68 houses and in arriving at gain on the sale of the houses in 1946, petitioner has claimed the cost of the 68 houses. Petitioner now admits that one house remained unsold at the end of 1946. This house was located at 801-10th Street and was occupied by Mr. H. G. Beckwith. [69]

"The respondent herein contends that two houses were sold in 1947 and that their cost must not be used in computing the gain on the sale of houses in 1946. The Government's contention is partially predicated upon the following statement taken from a statement sent to petitioner by Horace L. Miller which was found in petitioner's records of a sale in 1947."

The Government contends that.

The Court: I don't think I quite understand your position, Mr. Butler.

Mr. Butler: It was my understanding and I will apologize if it was true that there was no doubt that two houses were sold in 1947, that is 801, the house occupied by Mr. Beckwith, and the sale of 901, taken from Mr. Miller's records. It is my position that petitioner conceded that two were sold in 1947.

The Court: He didn't concede that in this stipulation.

(Testimony of Harry G. Beckwith.)

Mr. Butler: No, I can see that now and I apologize.

Mr. Foster: In order there may be no misunderstanding may I have the Court's permission to ask that question?

The Court: You may.

Q. At the end of the calendar year of 1946 how many houses of the eighty-five remained unsold?

A. One. [70]

Q. Were there any written leases? A. No.

Q. On any of these houses? A. No.

Q. Now, in the calendar year of 1946 what effort was made to sell the sixty-eight houses?

A. There was no particular effort made to sell them. The people came around and wanted them. They came in of their own account.

Q. What compensation did you receive for your services from Mr. Homann?

A. I received a weekly wage.

Q. Did you receive a commission on the sale of the houses? A. No.

Q. Did you have any other functions, any other jobs over there for Mr. Homann besides the servicing of these houses?

A. Just to look for any new business that might be in the offing.

Q. Did you find any? A. Yes.

Q. How many jobs did you find?

A. We bid on two schools over there and got one.

Q. Was that a large or a small contract? [71]

A. That was about four hundred thousand dollars.

(Testimony of Harry G. Beckwith.)

Q. And you were employed there during that entire school construction period?

A. I was employed there during the school construction, yes.

Q. In what capacity?

A. Well, you might say mostly public relations.

Q. Are you familiar with the furnace situation in those houses? A. Very.

Q. Will you describe the original furnaces?

A. The original furnaces—first of all we had to get permission from the Hanford authorities to buy furnaces and those were purchased through the University Sheet Metal Company, some concern back in the east—in Pennsylvania, if I remember rightly, and they were converted furnaces. They had been used as oil furnaces and had to be converted into wood or coal burning because of the fact the government was not allowing you to have oil at that time. The furnaces, when they came, were installed in the buildings and about the first trouble we had was two fires and the fire department notified us that we better get rid of those or have all the houses burned down. Then of those that remained—it was rather cold weather at the time—the people didn't want them out or didn't want them to stay in because they were [72] smoking and endangering the buildings.

Q. What was done with reference to leaving the furnaces in or taking them out?

A. We had to take them out.

Q. How many were removed?

(Testimony of Harry G. Beckwith.)

A. All of them.

Q. What was done with them?

A. They were thrown in the back yard and used as incinerators mostly by the people around there. Everyone thought it was a great joke.

Q. Did you finally make some disposition of them?

A. We gave some of them away to people who wanted them for incinerators. The motors and fans were good but the rest were no good whatever.

Q. Was there some salvage?

A. A little salvage, not much.

Q. With reference to ranges and refrigerators—

A. The ranges and refrigerators—a number of people came in and had their own refrigerators and ranges and we had permission, or authority, rather, from the F.H.A. at that period to charge an extra price of rental on the ranges and refrigerators. They had their own so they wanted them taken out and did not want to pay that extra rental. We took them out and sold them as salvage, as second-hand ranges and refrigerators. [73]

Q. Was Mr. Homann ever engaged in the business of selling or buying refrigerators and ranges?

A. Not as long as I have been with him.

Q. What has been his business?

A. A general contractor, mostly working on big buildings. I joined him at McChord Field where we were building for the Government. We built the general run of buildings, various kinds of buildings,

(Testimony of Harry G. Beckwith.)

from fire halls and churches and houses for Negro troops, etc., that were used in the fort at that time.

Q. During the time you were employed by Mr. Homann did he ever build any houses on his own account for others? A. No.

Q. Was he ever engaged in the real estate business?

Mr. Butler: Objection. I don't think whether he was engaged in the real estate business or not is for this witness to say, and it is purely repetitious. It is his opinion what business Mr. Homann was in and that is the ultimate question for the Court. I don't think it is pertinent and object on that ground.

The Court: That is a fact. Whether or not these sales took place in the course of business is one of the questions I have to decide.

Mr. Foster: Yes.

The Court: And that depends on a number of things. [74]

Mr. Foster: Yes. Here is a man employed by Mr. Homann and in charge of that operation all during that time and he had been employed by Mr. Homann from 1941 until 1949.

The Court: Suppose he is of the opinion that Mr. Homann was not in the real estate business and I, on the basis of the record here, am of the opinion that he was?

Mr. Foster: That goes to the weight of his testimony.

The Court: I am sustaining the objection.

Mr. Foster: I offer to prove by this witness now on the stand that he was employed by Mr. Homann

(Testimony of Harry G. Beckwith.)

from 1941 to 1949 and that he was familiar with his business during all that time and that he never was engaged in the real estate business.

Mr. Butler: I renew my objection.

The Court: Your objection has already been sustained.

Q. At any time was any change made in any of these houses to facilitate the sale of the houses?

A. Not beyond the changing of the furnaces and that change was not in particular to facilitate the sale. It had to be changed anyway.

Mr. Foster: I have nothing further.

Cross-Examination

By Mr. Butler: [75]

Q. How long did you say you had been with Mr. Homann, since '42? A. Since 1941.

Q. What has been your general job with him?

A. I have been a kind of assistant to him, a close assistant, in all his work.

Q. In the McChord Field job that you mentioned, for instance, were you just a kind of general assistant in that you took care of certain details?

A. No, at McChord Field we started in pretty well from scratch and I did just about everything.

Q. I mean generally. You would take care of certain details that he as a general contractor in his work could not handle? A. Yes.

Q. You testified that some Army colonel came in to you and told you that it was all over, that they were moving the Hanford employees? Do you re-

(Testimony of Harry G. Beckwith.)

member the colonel's name? A. Mathias.

Q. What inquiries did you make of the colonel? Did you ask, for example, when they were leaving and why they were leaving?

A. He said they were leaving immediately and they left that Sunday night.

Q. So you didn't talk to him much about it? [76]

A. There was no talking about it. He just said "It is in your lap." I said "What are we going to do? We came here with the idea we were going to rent only to the Hanford people." He said, "Well, you can rent to anyone you want to now."

Q. You testified that you were in charge of the advertising program. Did you write the advertisements? A. Yes.

Q. In these advertisements, which I understand were spot announcements over the radio, did you say anywhere that you would not sell? A. No.

Q. You say the radio program took place over two months? A. Yes.

Q. It was not renewed? A. No.

Q. Is it not a fact that at that time it was not necessary to renew them?

A. We didn't need them. They were coming to us.

Q. That would go to the whole general picture, things were so good there didn't have to be any further program?

A. At that time the G.I.'s were coming to see if they could not have those houses. One would pass it on to another and bring their friends in.

Q. Do you know, of your own knowledge, on

(Testimony of Harry G. Beckwith.)

these sales [77] the person who took over the finances of the house, took over the so-called mortgage? A. They all took it over.

Q. They all took it over?

A. Eventually, yes. It took some time to get some of them passed.

Q. You were in court this morning and again this afternoon and heard us talking about selling campaigns where certain signs were placed on the property by you or by somebody else, and advertisements. Is it not a fact none of that would be necessary to sell the houses or rent them after these announcements?

A. No signs were put up there.

Q. Would it be necessary to put signs up?

A. I would not think so.

Q. Did you have any specific instructions from Mr. Homann in regard to how to conduct sales in regard to these sales? A. With each sale?

Q. With sales in general?

A. When I informed Mr. Homann of the Hanford result and that they were going to move their men Mr. Homann was real sick about it and didn't know what to do and it was a question then where we would go to get anyone to rent these houses. People around there live there or have houses [78] of their own and we figured we were really in a bad spot.

Q. Is it not a fact you were worried about either renting or selling? I don't mean to confuse you. I

(Testimony of Harry G. Beckwith.)

apologize. You were worried you say about renting but didn't you have any discussion about selling?

A. Not at the time because these houses were all under mortgage made by Mr. Homann and he had to make the payments on the mortgage. Unless we got someone in there in a hurry to start making payments he was done for.

Q. Could not the same thing be done by selling the houses and have the buyers pay?

A. It could be but at that particular time——

Q. Did you have any specific discussions on this point? A. Yes.

Q. Do you recall any of those discussions?

A. We talked about it continually. It was on his mind.

Q. But he didn't instruct you not to sell?

A. We didn't think it favorable at that time. The people renting figured the houses were too high and also the rent too high.

Q. So, if you could have sold them you would have?

A. I don't know what we would have done at that time.

Q. You testified that in 1945 the houses were sold, [79] most of them were volunteers. What did you mean by that?

A. I mean you didn't have to, or, we didn't have to, go out and find those people. They came to the office and to us.

Q. You did have a rental office?

A. The house I was in there. That was head-

(Testimony of Harry G. Beckwith.)

quarters for any trouble that came up in plumbing, or anything like that. Everyone came there.

Q. Did you and your wife live in that house?

A. No, I lived there by myself.

Mr. Butler: I am sorry.

Q. When did you work on this school? Do you remember that specifically? I didn't get the date.

A. I was working on the school in 1946, I think it was, that particular school there.

Q. Was that in Sunnyside?

A. In Sunnyside, yes, the Washington School.

Q. Did you live in the project at that time?

A. Yes.

Q. You were not gone all day on that job?

A. No, no.

Q. You conducted the business of that job in your office, or how?

A. Well, I would go around and visit the superintendent of schools and the different people around there that I [80] thought might be influential in helping it along.

Q. I misunderstood. It was my understanding you were actually building the house, but you were competing?

A. Yes, you have to bid. They had trouble with the bond issue and required some assistance in getting a new one, etc., and also in getting people to come out for the election. It was very difficult to get them out for the school election.

Q. You handled that right from the project?

A. Right from the property, yes.

(Testimony of Harry G. Beckwith.)

Q. You testified about these furnaces. In your opinion would not that enhance the marketability of the house to put new furnaces in?

A. If you didn't put a new one in you would not have any market.

Q. So, your answer is the new furnaces would increase the marketability, so to say?

A. Oh, yes.

Q. You testified on direct examination that no other improvements were made except little minor repairs and I want to ask you this: were any necessary to improve the marketability of the houses?

A. Not to improve the marketability. Those were new houses and a new house has to be serviced for a little while. Something goes wrong with the plumbing or ventilation, [81] and things like that.

Q. Were any of these houses sold without being rented at all?

A. No, I think every house had already been rented, had a renter in them.

Q. You say you think. Do you know?

A. I know.

Q. What do you base that knowledge on?

A. Because I was right in the project. Those houses were all together and I was right in there all the time.

Q. Did you keep any records on that?

A. If I kept them at that time I would not know where they are now. They were mostly memorandums.

Q. There were eighty-five houses in this project

(Testimony of Harry G. Beckwith.)

and you don't remember if you kept any records but apparently you remember that all the houses were rented? A. Yes.

Q. You are absolutely certain that of eighty-five houses you can remember that none of them were vacant? A. Yes.

Q. And I ask again what do you base that on?

A. My own knowledge.

Q. Well, it just seems kind of strange you would not remember if you kept any records.

A. I probably had a record of the rental of [82] the houses but I could not tell you now exactly what it was.

Q. With regard to the sales in 1946 you testified that no particular effort was made to sell the houses?

A. No campaign or anything of that kind.

Q. I will ask you again is it not true that none was necessary? A. That is right.

Q. I have no further questions.

Mr. Foster: The petitioners rest.

The Court: I would like to ask one or two questions. I think perhaps, unless the details are contained in these exhibits, which of course I have not had an opportunity to analyze—that is Exhibits 3, 4 and 5—I would say that there was nothing in here to indicate what was the manner in which these houses were sold when they were sold. That is, were they all sold to one purchaser, or sold to individuals?

Mr. Foster: I would be pleased to develop that.

The Court: I really think you have a burden

(Testimony of Harry G. Beckwith.)

here. As I recall the cases a man can go into the business of selling a development even if he is in another business before.

Mr. Foster: May I take the witness?

The Court: I am asking you so you can do that.

Mr. Butler: Those records do indicate the date of [83] the sales and that they were to individuals.

The Court: I know they are in evidence but is it accepted that they are correct? They were not put on with any witness on the stand and it seems to me there is at least a possibility as far as petitioner's burden is concerned, as it is now, that it has not been discharged. At least, I don't want the record left that way if I can help it.

Redirect Examination

By Mr. Foster:

Q. How were these houses sold, all at once or to individuals as they appeared?

A. To individuals as they appeared.

Q. Was it possible to sell all the houses at one time to a single purchaser?

A. No, there was no one available. No one came forward and it never entered our minds that anyone would buy the whole thing.

The Court: As I understand the stipulation these houses, sixty-eight houses, were sold in a period of a few months, October to December, each one to a different purchaser. I understood that it was testified there were no "For Sale" signs on the property but it seems to me there is still a question of how it happens that purchasers could be found for

(Testimony of Harry G. Beckwith.)

that many houses in that short a time unless some effort were made to produce them. Perhaps the answer is— [84] I am asking now because I think it is important to find the facts. It is possible they were continually asked for sales but turned them down until this situation arose but I think it has not been covered.

Q. (By Mr. Foster): Did you have any difficulty with some of the tenants in some of the property?

A. Some difficulty in getting rid of them, yes.

Q. Tell the Court what that difficulty was.

A. We were under this rental control at that time and after we told them these houses were going to be for sale they told us where we stood on it.

Q. And what do you mean by that?

A. They told us they would go up and see the rental agency in Yakima and that we didn't have the power to get them out.

Q. Did you have some tenants there that from your standpoint were not desirable?

A. Yes, we had several. You see one reason why thoses houses were sold at that time was in influx of the population around there. That little town just about doubled in population. People were coming in to go to work on the numerous things that were springing up around there. Among them were Okies and Arkies and people of that kind who had never lived in a house of that kind before. When they got [85] in they immediately began to wreck the houses, was the sum and substance of it. They didn't

(Testimony of Harry G. Beckwith.)

know how to behave in a house. Some of them had never even had a bathroom in a house before.

Q. How many tenants of that category did you have?

A. I don't remember—possibly a dozen.

Mr. Butler: I move to strike. He doesn't remember.

The Court: Deny the motion.

Q. During what period of time in 1946 did these sales occur? Did they occur all at once or throughout the year?

A. Oh, it was spread out throughout the year.

The Court: That is what I am puzzling about. I thought the first, these sixty-eight, were all sold between October and December.

Mr. Foster: No, the sales were spread throughout the year.

Q. (By Mr. Foster): Do you know—do you have any knowledge when those sixty-eight houses were sold in the calendar year of 1946?

A. They were sold at different times. There were at least twenty of them sold to G.I.s, and it takes some time to perfect a sale. There might be twenty come through all at one time but the sale was on the way of being perfected during that time and others who were assuming the mortgages [86] on the property would have to go through the processing and know whether they were capable of carrying that mortgage through.

Mr. Foster: That is all.

Mr. Butler: I think I have no further questions.

(Testimony of Harry G. Beckwith.)

Mr. Foster: Petitioners rest.

The Court: I am not going to pursue this any further, and I hope it is reasonably evident now in the record, but I am still puzzled as to the facts because as I recall it there was a time when Mr. Homann decided he wanted to sell the houses and the question of whether there was any alteration in the manner of operation at that time is the thing I was interested in and if so was it consistent.

Mr. Foster: I am quite sure there was no alteration. I will ask the question.

Q. In the months from October to December, 1946, was there any difference in your plan of disposing of these houses?

A. No. What do you mean by "alteration"?

Q. Did you inaugurate a speed-up campaign on those houses from October to December?

A. No.

Q. In that period of time your operation with respect to the disposition of those units was the same as in the balance of the year? [87]

A. That is right.

Mr. Foster: That is all.

Mr. Butler: I have no questions.

Mr. Foster: Petitioners rest.

The Court: As I understand, the testimony now is there was no change in the operation and that is the way the record is.

Mr. Butler: I might just say this, the rental records show that one of the houses was sold apparently before any were rented. That was in 1944.

Mr. Homann testified that that was refunded, that that was not an actual sale but there were sales in 1945 and further sales in 1946, and at least one we know of in 1947.

The Court: Well, the question is to find what these properties were held for primarily and as I say I hope the facts are in the record from which that can be determined.

Mr. Foster: I would like to recall Mr. Homann.

The Court: I take it there is no objection?

Mr. Butler: No objection.

A. G. HOMANN

Redirect Examination

By Mr. Foster:

Q. You have heard the discussion here that the sale of these 1946 houses were between October and December? A. Yes. [88]

Q. Do you have an explanation for that?

A. I heard the questions the Judge asked Mr. Beckwith and I would like to answer that. In making these sales and making loans the lending agencies, whether G.I. or private, would not process one loan at a time. We would have accumulated a group and they would make the process of the group together and that is why it shows in a lump in the income tax return. Actually, the sales were made throughout the year but not processed as far as loans, etc.

Q. And the processing of those applications occurred between October and December?

A. That is when they went through, yes. That is

(Testimony of A. G. Homann.)

when they were completed and brought in, because I had to sign all the papers and I remember they would hold up the processing—the sales were held up for quite a long period of time.

Q. After the sale was made what method was used in financing those sales?

A. Between the amount of the new loan and the sales price the buyer paid in cash.

Q. You took individual mortgages? You gave an individual mortgage—the purchaser gave an individual mortgage on the unit on which he purchased? A. He refinanced it.

Q. The proceeds of that mortgage was used to retire the original mortgage loan? [89]

A. Yes.

Q. You were not a mortgagee?

A. My wife and I.

Q. You were not a mortgagor under the final purchaser's mortgage? A. No, sir.

The Court: First of all, Mr. Foster, would you not indulge me by taking another look at this tax return and see if you can agree there were sixty-eight houses sold between October and December, there in 1946?

Mr. Foster: Yes.

The Court: Because the question you asked a moment ago still said '46.

Mr. Foster: I mis-spoke myself.

The Court: I realize this is going back to testimony of this morning. As I understand he testified there was a time he changed his frame of mind with

(Testimony of A. G. Homann.)

respect to this property. You then wanted to sell it because you needed the cash for this other construction? Is that correct?

A. That is correct.

Q. Can you tell me approximately when that took place?

A. It was in the early part of 1946 and when the bank refused to make me any loans and stated that I would have to start paying back what I had borrowed at the rate [90] of \$5,000 per month and it forced me to raise money and the only way I could raise any was from the sale of these houses. As I stated before, my money was tied up in the foreclosure deal.

Q. That is what I understood before. I want to follow through. Were you satisfied that the process of selling these houses was progressing sufficiently satisfactorily so you didn't have to take any means of increased sales once you made up your mind you were going to sell?

A. The houses were selling faster than we could get the renters out. What held the sales up was the fact the renters were in and had a right to stay. I had to wait so long to get them out. It was hard to get renters out. I had my own home practically wrecked by renters I had in and still could not get them out.

Q. I understand the delay in getting renters out but what I am asking about is the process of finding prospective purchasers for this property.

A. The G.I.s were coming back from the war and

twenty some of them had their applications in, I believe, at practically the same time. The Rosa project had started developing and people wanted to come in and get homes.

Mr. Foster: That is a new irrigation ditch going through Wenatchee and Sunnyside which put barren land in cultivation and a lot of new businesses came in [91] which followed with it and a lot of people came to work on this project.

A. That is right.

* * *

Filed November 13, 1955, T.C.U.S. [92]

The Tax Court of the United States

Docket Nos. 37318 and 37319

A. G. HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANNA HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CERTIFICATE

I, Victor S. Mersch, Clerk of the Tax Court of the United States, do hereby certify that the fore-

going documents, 1 to 21, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designations of Contents of Record on Review," excepting Petitioners' exhibits 1 thru 5, which are separately certified and forwarded herewith, as the original and complete record in the proceedings before the Tax Court of the United States entitled: "A. G. Homann, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 37318" and "Anna Homann, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 37319" and in which the Petitioners in the Tax Court proceedings have initiated appeals above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of April, 1955.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 14737. United States Court of Appeals for the Ninth Circuit. A. G. Homann, Petitioner, vs. Commissioner of Internal Revenue, Respondent, and Anna Homann, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petitions to Review Decisions of the Tax Court of the United States.

Filed April 25, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals for the
Ninth Circuit

Docket No. 14737

ANNA HOMANN and A. G. HOMANN,

Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

STIPULATION

It is Hereby Stipulated that it is only necessary to print in the record herein the petition and answer in the case of A. G. Homann, Docket No. 37318, for the reason that the petition and answer in Docket No. 37319 is identical except in name.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for the Petitioners on
Review.

/s/ H. BRIAN HOLLAND,
Counsel for the Respondent on Review, Assistant
Attorney General.

[Endorsed]: Filed May 11, 1955, U.S.C.A.

Docket No. 37318

A. G. HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

SUPPLEMENTAL DOCKET ENTRIES

1955

Apr. 21—Transcript of original record sur petition for review sent Clerk U. S. Court of Appeals, Ninth Circuit.

June 21—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by G.C.

July 6—Proof of service filed.

July 14—Statement of points with proof of service by mail thereon, filed by G.C.

July 14—Designation of contents of record with proof of service by mail thereon, filed by G.C.

Docket No. 37319

ANNA HOMANN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

SUPPLEMENTAL DOCKET ENTRIES

1955

Apr. 21—Transcript of original record sur petition for review sent Clerk U. S. Court of Appeals, Ninth Circuit.

June 21—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by G.C.

July 6—Proof of service filed.

July 14—Statement of points with proof of service by mail thereon, filed by G.C.

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In the United States Court of Appeals
for the Ninth Circuit

T.C. Docket No. 37318

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

A. G. HOMANN,

Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 1, 1955, ordering and deciding that there is a deficiency in income tax for the taxable year 1946 in the amount of \$5,922.70. This petition for review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondent on review, A. G. Homann, is an individual with principal office and residence at Lacey, Washington. He filed his individual income tax return for the calendar year 1946 with the Collector of Internal Revenue for the District of Washington, located at Tacoma, Washington, and within

the judicial circuit of The United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The issues decided against the Commissioner are (1) whether the basis for computation of gain on sale of rental housing held primarily for sale to customers should be reduced by an allowance for depreciation; and (2) whether the proceeds received from the sale of furnaces, refrigerators and ranges as salvage, which appliances were originally installed in houses held primarily for sale to customers in the ordinary course of taxpayer's business, are taxable as ordinary income or capital gain.

As to issue (1), the Commissioner reduced the basis of houses sold by depreciation. The Tax Court decided against the Commissioner and held that since from the inception taxpayer held the property primarily for sale it would not qualify for the "use in trade or business" requirement of the depreciation deduction. Accordingly, no reduction in basis for depreciation in computation of gain on sale was held to be proper.

With respect to issue (2), certain appliances originally installed in the houses were removed and sold for salvage. The Commissioner held that the proceeds received from the sale are taxable as ordinary income. The Tax Court held the resulting income was capital gain because taxpayer was not in the business of selling second-hand equipment,

and the items in question were not held for sale in the ordinary course of taxpayer's business.

/s/ H. BRIAN HOLLAND,

Assistant Attorney General;

/s/ JOHN POTTS BARNES,

Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Filed June 21, 1955, T.C.U.S.

Docket No. 37318

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To Harry Ellsworth Foster, Esquire, 501 Security
Building, Olympia, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 21st day of June, 1955, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 21st day of June, 1955.

/s/ JOHN POTTS BARNES,

Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 28th day of June, 1955.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Respondent on
Review.

Received June 29, 1955, D.D.I.R.

Filed July 6, 1955, T.C.U.S.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 37319

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

ANNA HOMANN,

Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 1, 1955, ordering and deciding that there is a deficiency in income tax for the taxable year 1946

in the amount of \$6,202.94. This petition for review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondent on review, Anna Homann, is an individual with principal office and residence at Lacey, Washington. She filed her individual income tax return for the calendar year 1946 with the Collector of Internal Revenue for the District of Washington, located at Tacoma, Washington, and within the judicial circuit of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The issues decided against the Commissioner are (1) whether the basis for computation of gain on sale of rental housing held primarily for sale to customers should be reduced by an allowance for depreciation; and (2) whether the proceeds received from the sale of furnaces, refrigerators and ranges as salvage, which appliances were originally installed in houses held primarily for sale to customers in the ordinary course of taxpayer's business, are taxable as ordinary income or capital gain.

As to issue (1), the Commissioner reduced the basis of houses sold by depreciation. The Tax Court decided against the Commissioner and held that since from the inception taxpayer held the property primarily for sale it would not qualify for the "use in trade or business" requirement of the depreciation deduction. Accordingly, no reduc-

tion in basis for depreciation in computation of gain on sale was held to be proper.

With respect to issue (2), certain appliances originally installed in the houses were removed and sold for salvage. The Commissioner held that the proceeds received from the sale are taxable as ordinary income. The Tax Court held the resulting income was capital gain because taxpayer was not in the business of selling second-hand equipment, and the items in question were not held for sale in the ordinary course of taxpayer's business.

/s/ H. BRIAN HOLLAND,

Assistant Attorney General;

/s/ JOHN POTTS BARNES,

Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Filed June 21, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

Docket No. 37319

NOTICE OF FILING PETITION
FOR REVIEW

To Harry Ellsworth Foster, Esquire, 501 Security
Building, Olympia, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 21st day of June, 1955, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for

the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 21st day of June, 1955.

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 28th day of June, 1955.

/s/ HARRY ELLSWORTH FOSTER,
Counsel for Respondent on
Review.

Received June 29, 1955, D.D.I.R.

Filed July 6, 1955, T.C.U.S.

[Title of Court of Appeals and Cause.]

T. C. Docket Nos. 37318, 37319

STATEMENT OF POINTS

Comes Now the petitioner on review herein and makes this concise statement of points on which he intends to rely on the review herein, to wit:

The Tax Court of the United States erred:

1. In holding that since from the inception taxpayer held the property primarily for sale it would

not qualify for the "use in trade or business" requirement of the depreciation deduction, and that the Commissioner erred in reducing taxpayer's basis on account of depreciation "allowable."

2. In holding that the proceeds received from the sale of furnaces, refrigerators and ranges as salvage, which appliances were originally installed in houses held primarily for sale to customers in the ordinary course of taxpayer's business, are taxable as capital gain.

3. In failing to uphold the action of the Commissioner that the proceeds received from the sale of furnaces, refrigerators and ranges as salvage, are taxable as ordinary income.

4. In holding that there are deficiencies in income tax for the taxable year 1946 in the amount of \$5,922.70 in the case of A. G. Homann and in the amount of \$6,202.94 in the case of Anna Homann, rather than in the respective amounts of \$10,149.95 and \$10,457.70 as determined by the Commissioner.

5. In that its opinion and decisions are contrary to law and regulations.

/s/ H. BRIAN HOLLAND,

Assistant Attorney General;

/s/ JOHN POTTS BARNES,

Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Statement of Service attached.

Filed July 14, 1955, T.C.U.S.

The Tax Court of the United States
Washington

T. C. Docket Nos. 37318, 37319

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

A. G. HOMANN, ANNA HOMANN,

Respondents on Review.

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, numbered 22 to 29, inclusive, constitute and are all of the original papers on file in my office, as called for by the "Designation of Contents of Record on Review," document 29 in this record, in the proceedings before The Tax Court of the United States entitled: "A. G. Homann, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 37318," and "Anna Homann, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 37319," and in which [petitioner in the Tax Court heretofore initiated appeals in which the record was forwarded on or about April 21, 1955] the respondent in the Tax Court later initiated these appeals as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, supplementing those in the record on taxpayers'

appeals, and which original papers constitute a supplemental record.

In testimony whereof I hereunto subscribe my name and affix the seal of said Court at the City of Washington in the District of Columbia this 20th day of July, 1955.

[Seal] /s/ VICTOR S. MERSCH,

Clerk, The Tax Court of the
United States.

[Endorsed]: No. 14737. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. A. G. Homann, Respondent, and Commissioner of Internal Revenue, Petitioner, vs. Anna Homann, Respondent. Transcript of the Record. Petitions to Review Decisions of The Tax Court of the United States.

Filed July 21, 1955.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for
the Ninth Circuit.

No. 14737

United States
Court of Appeals

FOR THE NINTH CIRCUIT

A. G. Homann, *Petitioner*,

vs.

Commissioner of Internal Revenue, *Respondent*.

Anna Homann, *Petitioner*,

vs.

Commissioner of Internal Revenue, *Respondent*.

PETITIONERS' BRIEF

Harry Ellsworth Foster,

Counsel for Petitioners.

Office and Post Office Address
501 Security Building
Olympia, Washington.

FILED

OCT 11 1955

PAUL P. O'BRIEN, CLERK

No. 14737

United States
Court of Appeals

FOR THE NINTH CIRCUIT

A. G. Homann, *Petitioner*,

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PETITIONERS' BRIEF

Harry Ellsworth Foster,

Counsel for Petitioners.

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No. 14737

United States
Court of Appeals

FOR THE NINTH CIRCUIT

A. G. Homann, *Petitioner*,

vs.

Commissioner of Internal Revenue, *Respondent*.

Anna Homann, *Petitioner*,

vs.

Commissioner of Internal Revenue, *Respondent*.

PETITIONERS' BRIEF

HOMANN TAX BRIEF

OPINION BELOW

The Memorandum Findings of Fact and Opinion of the Tax Court (R. 14-26) are not officially reported.

JURISDICTION

Jurisdiction to review decisions of the United States Tax Court is conferred by Section 7482 of the 1954 Internal Revenue Code. These petitions for review involve a de-

ficiency in the income tax for the calendar year 1946 for petitioner A. G. Homann \$5,922.70, and for the petitioner Anna Homann, \$6,202.04 and are taken from decisions of the Tax Court entered March 1, 1955, (R. 27-28), pursuant to Memorandum Findings of Fact and Opinion (R. 14-26). Taxpayers are husband and wife residing in the state of Washington, a community property state, and filed separate income tax returns for 1946 (R. 15), in the Collector's office in Tacoma, Washington, all within the jurisdiction of this Court. Petitions for Review were filed March 28, 1955 (R. 29-30).

QUESTION PRESENTED

The sole issue is whether the profit realized from the sale of 68 houses in 1946 is taxable as ordinary income or as capital gains under *Section 117* of the *Internal Revenue Code of 1939*.

STATEMENT OF THE CASE

These consolidated cases (R. 4) involve income tax liability redetermined against petitioners for income tax deficiency for the calendar year 1946. Washington being a community property state, petitioners, husband and wife, filed separate income tax returns (R. 15). Petitioner has been a general contractor for thirty years and in 1944 began the construction of 85 houses at Sunnyside, in Yakima County, Washington, near the Hanford Engineer

Works, at a total cost of \$515,539.82, of which amount he borrowed \$450,000.00 (R. 17) plus a separate loan of \$45,000.00. All houses were rented in 1945 before any sales were consummated (R. 17). All tenancies were month to month with no written leases. Petitioner did agree orally that some tenants might apply the rent on the purchase price in the event of purchase.

The Court found the petitioner had never built any houses on his own account which were sold to others except those in controversy. He has never had a real estate brokers license and never before built houses on his own account for rental. During the year in question, the Court found (R. 18) that all houses were sold to volunteers and that no "For Sale" signs were ever displayed nor were newspaper advertisements carried.

The Court found (R. 19-20) that in 1945 petitioner started the construction of a cannery building in Olympia, Washington for the Midfield Packers at an estimated cost in excess of \$200,000.00 and that before completion, the Midfield Packers failed at which time petitioners had between \$50,000.00 and \$60,000.00 invested in the project. Petitioners filed a lien which was foreclosed, by decree entered September 9, 1949, and affirmed on appeal March 9, 1951 (*Homann v. Huber*, 38 Wash. (2d) 190, 228 P (2d) 466, (R). 20, 53). He completed the building at a

cost of approximately \$96,000.00. He still owns the building, the first floor of which is rented to the Olympia Brewing Company at a monthly rental of \$1,250.00 and the upper floor to the State of Washington at a monthly rental of \$450.00. 16 houses were sold in 1945 and 68 houses were sold in 1946. The Tax Court found that the 68 houses sold in 1946 were held primarily for sale to customers in the ordinary course of the petitioners' business (R. 22).

The taxpayers' original purpose was to rent the employees of the Hanford Engineer Works (R. 45, 81, 105-6, 52). When those employees were moved, a short radio campaign was conducted to rent the houses to others (R. 46) but no mention was made of sale (R. 62).

Prior to the freezing of taxpayers' bank credit, the houses were held for rent, but that plan was changed early in 1946 when the bank denied taxpayers further credit and demanded liquidation of the existing advances at the rate of \$5,000.00 a month (R. 105-6). Thus, the sales of the houses were forced (R. 52, 106). It was impossible to sell all of the houses in a single transaction, (R. 100), necessarily resulting in individual sales. The houses were then selling as fast as the renters could be removed (R. 106, 94).

The real estate broker, Mr. Horace L. Miller, was dis-

abled by paralysis and was, therefore, unable to testify (R. 80, 87).

ASSIGNMENT OF ERROR

The Tax Court erred in finding that the 68 houses sold by petitioner during 1946 were held primarily for sale to customers in the ordinary course of business within the meaning of *Section 117 of the Internal Revenue Code of 1939* in that such determination is contrary to the law and not supported by any evidence.

SUMMARY OF ARGUMENT

The profit realized by petitioners on the sale of the 68 houses is taxable as capital gain. This is so for the following reasons:

1. Petitioners' uncontradicted purpose was to own rental property.
2. All of the houses were rented before sale.
3. There was no activity to stimulate sales. All purchasers were volunteers. Houses sold themselves. Broker closed sales at one-half ordinary commission.
4. Taxpayer is a general contractor and devoted his time to that business. Moreover, taxpayers were at all times engaged in the business of renting real property and still are.
5. Taxpayers have no prior or subsequent sales history. Except for the houses in question, none were ever built by the taxpayers for either rental or sale.

6. April 7, 1945, taxpayer began construction on building for concern in Olympia which subsequently failed, tying up \$50,000.00 to \$60,000.00 of petitioners' capital. Bank loans ranging from \$45,000.00 to \$60,000.00 were called, necessitating sale of houses. Lien on Olympia building foreclosed, purchased by taxpayers and finished at a cost of \$96,000.00. They still own this building which produces rental income of \$1,700.00 monthly. The 68 houses which taxpayers hoped to rent were liquidated in order to save the other investment.

The finding that the houses sold by the petitioners in a taxable year were held for sale to customers in the ordinary course of the taxpayers' business is unsupported by the evidence and is contrary to law. Frequency and continuity of sales by themselves do not sustain the finding nor is the inadequacy of the rental income decisive.

ARGUMENT

Scope of Review

At the outset, a brief discussion of the scope of review of factual determinations of the Tax Court is required. *Subdivision (a) of Sections 7482 of the 1954 Internal Revenue Code* provides that the decision of the Tax Court may be reviewed in the same manner as decisions of the District Courts in civil actions tried without a jury. While the District Court by *Subdivision (a) of Rule 52 of the Rules of Civil Procedure* is required to find the facts and separately state its conclusions of law therefrom, the Tax

Court is under no such compulsion but commingles both.

Here upon a partial stipulation of facts and the remainder from undisputed evidence, the Tax Court concluded that the 68 houses sold in 1946 were held primarily "for sale to customers in the ordinary course of petitioners business."

This is contrary to law and unsupported by evidence and therefore clearly erroneous. The only circumstance pointing to that conclusion is that 68 houses were sold in 1946 but it has been determined that frequency and continuity of sales alone does not justify this conclusion.

1. *Lobello v. Dunlop*, 5th Cir. 210 F. 2d 465
2. *Victory Housing v. C. I. R.*, 205 F. 2d 371
3. *Delsing v. U. S.*, 186 F. 2d 59
4. *Goldberg v. C. I. R.*, 223 F. 2d 709

This precise finding in the *Goldberg* case was predicated upon the sale of 90 houses in 1946. The 5th Circuit reversed the Tax Court (223 F. 2d 711, 712). The conclusion expressed by that Court was that findings induced by an erroneous view of the law are not binding nor are findings combining both fact and law when there is error as to the law.

This Court in *McGah v. Commissioner*, 210 F. 2d 769, held that such a finding was not binding upon the Court of Appeals. The taxpayers showing here is much stronger

and the Court in the McGah case declared that a mistake had been made. Other cases reaching similar conclusions are cited in the McGah and Goldberg cases.

NO OPTIONS

The Court found there were no written leases but that there were oral arrangements which amounted to an option to buy. This conclusion is unwarranted by the evidence because it is a matter of state law and the Supreme Court of Washington has held in an unbroken line of decisions that an oral agreement for the sale of real property is void:

Chamberlain v. Abrams, 36 Wash. 587, 79 Pac. 204;
Somers Company v. Pix, 75 Wash. 233, 134 Pac. 932;
Brown v. Kausche, 98 Wash. 470, 167 Pac. 1075;
Pitman v. Smith, 158 Wash. 467, 291 Pac. 334.

What was petitioners' business?

Primarily, of course, the husband petitioner is a general contractor which requires his full time and energies but for the purpose of this case, however, during the tax year in question and since, the petitioners have also been in the business of renting real property. All of the 85 houses were rented in 1945 and the remaining 68 were rented during 1946 up to the time of sale. Taxpayers have never, either during the tax year in question or since, abandoned the business of owning real property for rent-

al income.

Early in 1946, the bank to whom the taxpayers were indebted between \$40,000.00 and \$60,000.00, refused further credit and demanded liquidation of the existing indebtedness at the rate of \$5,000.00 per month, which necessitated the sale of the houses.

In April of 1945, petitioner started the construction of a building in Olympia, Washington for the Midfield Packers, but the building was uncompleted at the time of the failure of the Midfield Packers when they owed taxpayers between \$50,000.00 and \$60,000.00 on the building. While the taxpayers had lien rights in that building which subsequently ripened into ownership, they then had no interest in it which could be either sold or hypothecated. Foreclosure ensued and taxpayers purchased the property at the foreclosure sale and subsequently completed the building at an added cost of \$96,000.00. Since then it has produced them a monthly rental income of \$1,700.00.

Petitioners reside in Olympia while Sunnyside is in the Yakima Valley, approximately 200 miles distant. If all other circumstances were equal, therefore, the rental investment at home was more desirable.

The view of the Tax Court was that the 68 houses in 1946 were held primarily for sale to customers in the

ordinary course of the petitioners' business. It concluded that the holding of the property "during the taxable year" was decisive. But this is entirely erroneous because it forecloses the possibility of capital gains treatment on the profit from the sale of investment real property. After a decision to sell is reached, the rental purpose disappears.

Until the bank demanded liquidation of petitioners' outstanding indebtedness, the houses were held for rental and were rented. After that demand, however, they were sold with all possible dispatch and during that time they were held for sale but that did not change petitioners' business. The opinion in the first *McGah* case, 193 F. 2d 662, 663, vacated the general finding and remanded the case for a specific finding. Your Honors there said:

"The Tax Court found that, at the time of their sale, the 14 houses were held by petitioners primarily for sale to customers in the ordinary course of petitioners' trade or business. There was, however, no finding as to whether the 14 houses were so held prior to their sale, or as to when and how long, if at all, the 14 houses were so held prior to their sale."

Some species of property are susceptible of instantaneous sale or in a single transaction, illustrative of which are listed securities or a building. 68 houses on the other hand must be sold individually and when the change in petitioners' circumstances occurred, the sale was made with

dispatch and without sales activity because the houses were selling faster than the renters could be evicted. This view is emphasized in the following passage from the opinion in *Victory Housing No. 2*, 205 F. 2d 371, 373 (10 C. A.):

“The fact that 42 units were sold over a period of six months does not establish a real estate business or the sale of property in the ordinary course of such a business. If a farmer has twenty separate farms which he used in his farming business and, desiring to quit farming and to dispose of his holdings, sells them in the course of three or four weeks, or three or four months, the fact that there are a considerable number of sales in a relatively short time standing alone is not sufficient to put him in the business of selling farms in the ordinary course of such a business. The same must be said with respect to these 42 units.”

A similar conclusion was reached in the 8th Circuit, *Dillon v. C. I. R.*, 213 F 2d 218, 220. The following paragraph in that opinion is quite significant:

“The Tax Court bases its determination upon the ground that “We must determine the purpose for which the property is held during the taxable year (1946) in question,” and that after October 15, 1945, “the 20 houses in question were held primarily for sale to customers in the ordinary course of business in the taxable year and net profits . . . are taxable as ordinary income.” The 20 houses were sold during the period from January 1, 1946, to August 8, 1946. The Court arrives at its conclusion on this point by a consideration of the business done in the taxable year 1946, and attaches no significance to the

resolution of the taxpayer to liquidate his holdings in the houses in the fall of 1945. The Court cites one of its own opinions only to support its theory. Strictly applying this rule had the taxpayer decided to liquidate his holdings in December, 1945, and failed to complete the liquidation before January, 1946, the result would have been the same. Neither a statute nor the decision of any court is cited to support the theory of the Tax Court. We think the principle applied is neither legal nor reasonable, but that it is clearly erroneous. Under the evidence here the petitioner was not in the real estate business in Omaha in 1946. He was liquidating his ownership of 20 houses through a corporation engaged in the real estate business. There is no conflict in the evidence on this decisive point."

And, significantly, the 5th Circuit in *Goldberg v. C. I. R.*, 223 F. 2d, 709, 712 said:

"The frequency and continuity of sales is also important. If a rental corporation's assets are sold in a single transaction to a single purchaser, it could not be reasonably contended that there was a sale to a customer in the regular course of business. But more often the owner sells his rental properties piecemeal to different individuals. How frequent the sales are depends on many circumstances; the extent to which the seller turns his talents to the promotion and solicitation of sales, the number of units in the rental project, and the state of the market. Only the first of these circumstances has any rational connection with the question whether the owner has changed his business to selling, or is simply liquidating his business. Thus the frequency and continuity of sales factor is significant only so far as it reasonably justifies the conclusion that the owner somehow promoted the sales. The courts do not deny capital gain bene-

fits simply because a large number of sales are made in a short period; for if the owner has a large number of houses on a seller's market, it is quite possible that he may sell them continuously without any sales promotion or solicitation."

A like conclusion was reached in *McGah v. Commissioner*, 210 F. 2d 769.

Of course, the primary business of the petitioner, A. G. Homann, was that of a general contractor, but for the purposes of this case he was also in the business of renting real property and that business never changed. While he had houses for rent in 1946, since then he has had a building for rent. It must be conceded that during the time the houses were rented that they constituted real property used in the taxpayers rental business as was said in *Victory Housing No. 2 v. C. I. R.*, 205 F. 2d 371, 372:

"In order then to uphold the finding and judgment of the Tax Court, there must be evidence supporting a finding that petitioner changed the nature of its business or enlarged its business so as to include therein not only its rental business but a general real estate business and that it placed these capital assets into its real estate business and thereafter disposed of them in the usual course of such business."

The Tax Court placed undue emphasis upon the disparity between the rental income and the sales income (R. 21-22). The rental income in 1945 was only \$4,892.85, while the sales income was \$10,346.43 and the rental ex-

penses exceeded \$9,600.00 and that in 1946, the income from rents showed a loss of \$1,034.25 while the income from sales was in excess of \$20,000.00. But that overlooks the fact completely that since the liquidation of the housing investment and the acquisition of the Olympia building investment this was completely reversed with no sales income at all and a rental income of \$1,700.00 monthly or an annual rental income of \$20,400.00.

Taxpayer testified that his purpose was to acquire rental property at the time he built the houses. It was impossible for him to hold the houses for that purpose for reasons already detailed, but after the liquidation of those houses, he acquired another asset which fulfills his original aim in consequence of which he is still in the rental business and successfully so.

The reason which prompted Congress to enact the Capital Gains Provision in *Section 117 (j) of the 1939 Internal Revenue Code*, was that the profit realized upon sales resulting from an increase in value during the time property was held for investment was properly taxed as capital gain as opposed to ordinary income resulting from sales to customers in the ordinary course of the taxpayers business.

The disparity between the rental income and the sales income is not controlling. In *Delsing v. U. S.*, 186 F (2d)

59, 61, the Court of Appeals in the Fifth Circuit declared:

“The disparity between income from sales and from rentals is not controlling. Under the facts and circumstances of this case, we find no permissible basis for a determination that the sales of the originally constructed defense rental housing units constituted a disposition of ‘property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,’ so as to render the profit taxable as ordinary income.

“We think the transactions evidenced the sale of capital assets and that accordingly the judgment must be, and is, reversed and the cause remanded with direction to enter judgment in favor of the taxpayer for the amount of refund claimed.”

And, more recently, in the *Goldberg v. C. I. R.*, 223 F. 2d 709-713, reiterated the same view in this sentence:

“The fact that the rental business had been unprofitable, to which the Tax Court attached such significance, is fully as consistent with a decision to liquidate the property opportunely, as to turn it into another more profitable type of business.”

The liquidation of an investment unaccompanied by any considerable sales activity results in capital gain.

Dillon v. C. I. R., 213 F. 2d 218

Goldberg v. Commissioner, 223 F. 2d 709

Victory Housing No. 2 v. C. I. R., 205 F. 2d 371

U. S. v. Robinson, 129 F. 2d 297

Farley v. C. I. R., 7 T. C. 198

The Tax Court considered of controlling importance

the volume of the taxpayers sales (68) during the tax year 1946 in determining that such sales were made to customers in the ordinary course of the taxpayers business, but this view is erroneous. It was answered in the Goldberg case, 223 F. 2d 709, 713, in the following paragraph:

“(3) In short, the only evidence that the corporation was engaged in the business of selling real estate was the frequency and continuity of sales, and this for a comparatively short time. Under the circumstances, the fact was equivocal, and that fact alone is not sufficient to support a finding of the ultimate fact that Pinecrest was engaged in selling houses as a business. We conclude that the Tax Court’s finding was based upon an erroneous application of the law. *Lobello v. Dunlap*, 5 Cir., 210 F. 2d 465; *Dunlap v. Oldham Lumber Co.*, 5 Cir., 178 F. 2d 781; *United States v. Robinson*, 5 Cir., 129 F. 2d 297; *Victory Housing No. 2 v. Commissioner*, 10 Cir., 205 F. 2d 371.”

CONCLUSION

For the reason stated, the decision of the Tax Court that the 68 houses were held by petitioners for sale to customers in the ordinary course of taxpayers’ business is erroneous and should be reversed.

Respectfully submitted,

HARRY ELLSWORTH FOSTER
501 Security Building
Olympia, Washington
Counsel for Petitioners.

APPENDIX A

Sec. 117. CAPITAL GAINS AND LOSSES

(a) Definitions.—As used in this chapter—

(1) Capital Assets. — The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business, but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(B) Property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), or real property used in his trade or business;

(C) a copyright; a literary, musical or artistic composition; or similar property; held by—

(i) a taxpayer whose personal efforts created such property, or

(ii) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part

by reference to the basis of such property in the hands of the person whose personal efforts created such property; or

(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

* * *

(j) Gains and Losses from Inventory Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.—

(1) Definition of property used in the trade or business.—For the purposes of this subsection, the term “property used in the trade or business” means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or C . . .

**In the United States Court of Appeals
for the Ninth Circuit**

A. G. HOMANN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ANNA HOMANN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

A. G. HOMANN, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ANNA HOMANN, RESPONDENT

*ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE
TAX COURT OF THE UNITED STATES*

BRIEF FOR THE COMMISSIONER

H. BRIAN HOLLAND,
Assistant Attorney General.

ELLIS N. SLACK,
ROBERT N. ANDERSON,
JOHN J. KELLEY, JR.,
Attorneys,
Department of Justice,
Washington 25, D. C.

FILE

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PAUL P. O'BRIEN, CLERK



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**In the United States Court of Appeals
for the Ninth Circuit**

No. 14737

A. G. HOMANN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ANNA HOMANN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

A. G. HOMANN, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ANNA HOMANN, RESPONDENT

*ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE
TAX COURT OF THE UNITED STATES*

BRIEF FOR THE COMMISSIONER

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 15-26) are not officially reported.

JURISDICTION

The petitions for review (R. 29, 31-32, 113-115, 116-118) involve deficiencies in income taxes determined

by the Commissioner against the taxpayers for 1946. On July 27, 1951, the Commissioner mailed the taxpayers notices of deficiencies in taxes for that year. (R. 7-12.) Within ninety days thereafter and on October 24, 1951,¹ the taxpayers filed petitions with the Tax Court of the United States for a redetermination of the deficiencies for 1946, under Section 272 (a)(1) of the Internal Revenue Code of 1939. The decisions of the Tax Court that there were deficiencies in income tax for 1946 were entered on March 1, 1955 (R. 27-28), and the cases were brought to this Court by petitions filed by taxpayers on March 31, 1955 (R. 29, 31-32) and by the Commissioner on June 21, 1955 (R. 113-115, 116-118). Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court's finding that the 68 houses in question were held primarily for sale to customers in the ordinary course of taxpayer's business within the meaning of Section 117 (a) and (j) of the Internal Revenue Code of 1939 was clearly erroneous.

2. Whether the Tax Court correctly decided that taxpayer's basis for the housing in question should not be reduced by an allowance for depreciation under Section 113 (b)(1)(B) of the 1939 Code.

3. Whether the Tax Court correctly decided that the gain received by the taxpayer on the disposition of various furnaces, ranges and refrigerators originally installed in the houses in question but later removed

¹ Although this date does not appear in the printed record it is found in the record on review.

and sold, constituted long-term capital gain under Section 117 of the 1939 Code rather than ordinary income.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and Regulations are set forth in the Appendix, *infra*.

STATEMENT

The facts as stipulated and as found by the Tax Court (R. 15-22) are as follows:

A. G. Homann, hereinafter called the taxpayer, and Anna Homann, his wife, resided in Olympia, Washington, a community property state, at all times material herein. They filed separate income tax returns for the years 1945, 1946 and 1947 with the Collector for the District of Washington. (R. 15.)

Taxpayer is a general contractor in Olympia, Washington. At the present time he maintains his office in Lacey, Washington, which is about four miles east of Olympia, Washington. Taxpayer has been engaged in the general contracting business for 30 years, and is a member of the Associated General Contractors of America. (R. 15.)

Taxpayer's contracting business is conducted by him, individually, under the name of A. G. Homann, General Contractor. No one else has any proprietary interest in his business. (R. 15.)

During World War II, taxpayer worked on war projects. Some time prior to July, 1944, the Hanford Engineering Works, hereinafter sometimes called Hanford, requested that 100 single dwelling homes be built to house 100 of its employees. Taxpayer first learned about the proposed project from some friends at the

Seattle regional office of the Federal Housing Authority, hereinafter referred to as F.H.A. After finding out about the project, taxpayer went to Sunnyside, Washington, and talked to a committee which had been formed to promote the construction of such houses. (R. 15-16.)

After investigating what he had heard, taxpayer agreed to proceed with the construction of the houses. In or about July, 1944, taxpayer started construction on 85 single dwelling houses in Sunnyside, Washington. Another contractor in Sunnyside built the remaining 15 houses desired by Hanford. (R. 16.)

Taxpayer constructed his houses on a tract of land which he purchased, replatted and recorded as Homann's Addition to Sunnyside. At least 100 lots were purchased. F.H.A. required that the lot for each house be not less than 60 feet wide. Taxpayer's plat was submitted to F.H.A. and the houses were all approved by that agency. F.H.A. places a ceiling on borrowing in connection with its authorized projects. (R. 16.)

When taxpayer first learned about the project he was told that he could rent or sell only to Hanford employees. Early in the spring of 1945, Colonel Mathias, who was in charge of Hanford, advised taxpayer's representative, Beckwith, without previous warning, that the Hanford employees were to be moved to Oak Ridge, Tennessee, and that henceforth there would be no Hanford employees available to occupy the houses. None of the houses were ever rented or sold to Hanford employees. The houses were completed in the spring of 1945. Lawns and shrubs were put in later when the ground was dry enough to work. (R. 16-17.)

In order to finance this project, taxpayer had borrowed about \$450,000 through Sherrill and Roberts, the lending agency for the project. Taxpayer paid approximately \$20,000 for the land and his own investment in the project fluctuated between \$20,000 and \$60,000. The amount paid by taxpayer for the land and the labor met the minimum requirements necessary to obtain this loan. In May, 1944, taxpayer also borrowed \$45,000 from the National Bank of Commerce in Olympia, Washington. (R. 17.)

The restrictions on renting and selling solely to the Hanford employees not being effective, taxpayer conducted a radio campaign over Station KIT in Yakima, Washington. This program lasted for two months and consisted of spot announcements. It was handled by Beckwith and taxpayer approved the plan. All of the houses were rented in 1945, before any sales were consummated. (R. 17.)

Taxpayer rented the houses on a month-to-month basis. There were no written leases. There were several oral agreements entered into whereby rent would be credited to the purchase price. These agreements amounted to a rental arrangement with an option to buy. All tenants who wanted to buy could have this arrangement. (R. 17.)

F. H. A. restrictions through the latter part of 1945 allowed up to 20 percent of its authorized housing to be sold. The balance had to be rented. Sixteen of taxpayer's houses, approximately 20 percent, were sold in 1945. Sixty-eight of the houses were sold in 1946, after removal of all F. H. A. restrictions on percentage of sales. Only one house remained unsold at the end of 1946. This house, the one occupied by Beckwith as an

officer, was sold in 1947, and a commission of \$300 was paid on the sale. All of the houses were sold to individuals. Each purchaser refinanced his purchase, and the proceeds of his mortgage were used to retire the original mortgage loan. Sales were negotiated continuously throughout the years material herein, beginning in April, 1945. The sales were closed in groups at irregular intervals because the lending agencies which refinanced the purchases would not process individual mortgage loans, but required taxpayer to wait until a group could be accumulated. (R. 17-18.)

At all times material herein, the houses were under rent control. This restriction did not change by reason of the removal of the Hanford plant and the elimination of restrictions on public rental. (R. 18.)

Taxpayer has never built any houses on his own account which were sold to others except the houses in controversy herein. He has never had a real estate broker's license. He had never previously built houses on his own account for rental purposes. (R. 18.)

Horace Miller was a real estate agent in the town of Sunnyside during all years material herein, and served as taxpayer's agent in the handling of money transactions. Miller was not the only real estate agent in Sunnyside. Miller was to get a 5 percent commission for collecting and transmitting rents to taxpayer and a 2½ percent commission on the sale of the houses. He always had authority to sell the houses if he found a buyer. (R. 18-19.)

Miller took a deposit on the sale of a house in September, 1944. Miller had reason to believe that he was acting in taxpayer's behalf. (R. 19.)

Taxpayer reported the gain realized on the sale of

the 16 houses sold in 1945 as short-term capital gain. Taxpayer had been in doubt as to whether those houses had been held for the 6 months necessary to qualify for capital gains treatment. Those houses were all sold to people who purchased without solicitation. (R. 19.)

Sales of the 68 houses sold in 1946 were made to people who came in to purchase voluntarily. No "for sale" signs were ever displayed on any of the houses, and such advertisements were not carried in the newspaper. (R. 19.)

The town of Sunnyside doubled in population during the period in controversy and taxpayer's houses were selling without difficulty. At this time veterans of World War II were coming back and wanted homes. Most of the houses were sold to returning veterans. It was not necessary to put "for sale" signs up or to conduct a selling campaign. (R. 19.)

Miller kept separate account of the income from rentals and the income from sales after August 1, 1945. (R. 19.)

Taxpayer did not know how much activity was carried on by Miller in selling his 85 houses. Taxpayer's superintendent did not know how much sales activity was carried on by Miller. (R. 20.)

Beckwith was employed by taxpayer from 1941 until 1949 as an assistant and in this capacity he had charge of the houses and looked for prospective new business. He was the only employee retained permanently and he lived in one of the houses which served as his office. Beckwith received a weekly wage. (R. 20.)

The houses were relatively new when they were sold and few repairs were necessary in order to improve the marketability. (R. 20.)

After the houses were completed taxpayer went to the project no more than once every four or five months. (R. 21.)

The total cost of the 85 houses, according to the Sunnyside books, was \$515,539.82. Taxpayer charged off \$94,133.57 on the 1945 income tax return and \$415,298.25 on the 1946 income tax return. On his 1946 income tax return, taxpayer also charged off the amount of \$18,310.75 under the heading of expenses of sale and cost of improvements subsequent to acquisition. (R. 21.)

In taxpayer's 1945 individual income tax return the sales of the houses were listed under a schedule entitled short-term capital assets. Under the heading of "date acquired" the houses were listed as having been acquired July 1, 1945. Under the heading, "date sold," 15 of the houses were listed as having been sold September 1, 1945, and one house was listed as having been sold August 1, 1945. The respective gain on the sale of these houses in the amount of \$10,306.43 was included in income as net short-term capital gain. On a schedule attached to taxpayer's 1945 income tax return the cost of the Sunnyside houses was shown at \$500,533.57 (84 houses at \$5,890 each and one house at \$5,773.57). (R. 21.)

On taxpayer's 1946 individual income tax return the gain on the sale of the 68 houses was included under long-term capital gains and losses with the date sold being listed as October through December, 1946. (R. 21.)

In 1945, taxpayer's income from rents was \$4,892.85. His income from sales of the houses was \$10,306.43. Rental expenses totaled \$9,606.53. Expenses included

interest, taxes, insurance and utilities, but nothing for depreciation or salary to Beekwith. (R. 21-22.)

In 1946, the income from rents showed a loss of \$1,034.25. Repairs were deducted in the amount of \$14,828.98 and other expenses totaled \$2,454.36. Income from sales in that year was \$20,050.98. (R. 22.) Taxpayer claimed no depreciation in 1946. (R. 38.)

The houses were originally equipped with refrigerators and ranges. Some occupiers owned their own refrigerators or ranges and did not desire to purchase or rent a house unless these items were removed. Many were removed and sold for salvage value. Taxpayer realized \$6,218.88 from the salvage of the refrigerators. (R. 22.) Some furnaces were defective and removed, \$325 was realized from their partial disposition on July 23, 1946, and \$350 on November 8, 1946. (R. 22.)

The Tax Court found that the taxpayer was never in the business of selling second-hand ranges, refrigerators or furnaces. (R. 22.)

The Tax Court also found that the houses which taxpayer sold in the taxable year 1946 were held primarily for sale to customers in the ordinary course of his business. (R. 22.)

STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in holding that since taxpayer held the property primarily for sale he would not qualify for the "use in trade or business" requirement of the depreciation deduction and also that the Commissioner erred in reducing taxpayer's basis on account of depreciation allowable.

2. The Tax Court erred in holding that the proceeds received by the taxpayer from the sale of furnaces, re-

frigerators and ranges, which appliances were originally installed in houses held primarily for sale to customers in the ordinary course of taxpayer's business, are taxable as capital gain rather than as ordinary income.

SUMMARY OF ARGUMENT

1. The principal question presented in these cases is whether the profit realized by taxpayer and his wife from the sale of the 68 houses in 1946 should be taxed as ordinary income or as capital gain. The profit should be taxed as ordinary income if the houses were held by the taxpayer primarily for sale to customers in the ordinary course of his business within the meaning of Section 117 (a) and (j) of the Internal Revenue Code of 1939. The Tax Court found that the 68 houses were held by the taxpayer primarily for sale to customers in the ordinary course of his business and therefore the gain realized on their sale was taxable as ordinary income. Whether the property was so held is, of course, a question of ultimate fact, no single circumstance being conclusive, and the Tax Court's finding to that effect should not be disturbed unless clearly erroneous. Therefore, we need only determine whether that finding is supported by the record.

Taxpayer contends that he was in the business of building houses for rental. However, we submit that in the light cast by the Tax Court's application of the various guides, which have been helpful in like cases, it was fully warranted in finding that the taxpayer was engaged in the business of building houses for sale. It is clear that there is substantial evidence in the record that the 68 houses were held *primarily* for sale to customers in the ordinary course of taxpayer's business

within the meaning of Section 117 (a) and (j) of the 1939 Code.

2. The Tax Court erred in deciding that taxpayer's basis for the 68 houses should not be reduced by allowable depreciation under Section 113 (b)(1)(B) of the Internal Revenue Code of 1939. It is very clear that while the houses in question were held *primarily* for sale they were nevertheless also held until that time for the production of income (rentals). Thus the property falls within the ambit of Section 23(1)(1) and (2) of the Internal Revenue Code of 1939. Section 113 (b)(1)(B) of the 1939 Code provides that in arriving at the adjusted basis of property for the purpose of determining the gain or loss upon its sale taxpayers shall make an adjustment for depreciation to the extent allowed but not less than the amount allowable. Therefore, taxpayer's basis for the 68 houses should have been reduced by the appropriate depreciation.

3. The Tax Court also erred in holding that the proceeds received by the taxpayer from the salvage sale of furnaces, refrigerators and ranges were taxable as capital gain rather than as ordinary income. The record reveals that the aforementioned items were an integral part of the houses taxpayer built for sale, and must be considered as held primarily for sale to customers in the ordinary course of his business. Furthermore, since the gain resulting from the sale of the furnaces, ranges and refrigerators was derived from articles used in taxpayer's trade or business it is deprived of capital gains treatment and must be taxed as ordinary income.

ARGUMENT

I

There is Ample Evidence in the Record to Support the Tax Court's Finding that the 68 Houses in Question Were Held Primarily for Sale to Customers in the Ordinary Course of Taxpayer's Business Within the Meaning of Section 117(a) and (j) of the Internal Revenue Code of 1939

In 1946, the taxpayer sold 68 houses in Sunnyside, Washington. The taxpayer and his wife reported the profits realized from the sales in their separate returns for 1946 as long-term capital gain. Later the Commissioner determined deficiencies against the taxpayer and his wife for the year 1946 on the ground that the profits derived from the 68 houses constituted ordinary income rather than capital gain since the units were held primarily for sale to customers in the ordinary course of taxpayer's business. The taxpayer and his wife petitioned the Tax Court for a redetermination of the asserted deficiencies and that court found (R. 22):

The houses which petitioner sold in the taxable year 1946 were held primarily for sale to customers in the ordinary course of petitioner's business.

The Tax Court thereupon concluded that the gain derived therefrom was properly treated by the Commissioner as ordinary income rather than capital gain. (R. 25.)

This Court has been confronted with the question of whether property was "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business," under subsection (a) and (j) of Section 117, Internal Revenue Code of 1939 (Appendix, *infra*), in an impressive array of cases. *Cohn*

v. *Commissioner*, decided October 1, 1955 (1955 C.C.H., par. 9674); *Stockton Harbor Indus. Co. v. Commissioner*, 216 F. 2d 638; *McGah v. Commissioner*, 210 F. 2d 769; *Jones v. Commissioner*, 209 F. 2d 415; *Palos Verdes Corp. v. United States*, 201 F. 2d 256; *McGah v. Commissioner*, 193 F. 2d 662; *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263; *Rubino v. Commissioner*, 186 F. 2d 304, certiorari denied, 342 U.S. 814. Here the question to be decided is essentially one of fact and a trial court's finding that property was so held by a taxpayer is not to be disturbed unless clearly erroneous. *Cohn v. Commissioner*, *supra*; *Stockton Harbor Indus. Co. v. Commissioner*, *supra*; *Rollingwood Corp. v. Commissioner*, *supra*; *Rubino v. Commissioner*, *supra*; *Gensinger v. Commissioner*, 208 F. 2d 576 (C.A. 9th).

As this Court and others have often pointed out there is no fixed formula or rule of thumb for determining whether property sold by a taxpayer was held by him primarily for sale to customers in the ordinary course of his business. For each case, in the last analysis, must rest on its own peculiar facts. There are, however, certain factors which have been recognized as helpful guides in ascertaining the correct result. Among these are (1) the purpose for which the property was acquired, (2) the frequency and continuity of sales as opposed to isolated transactions, (3) the substantiality of the sale transactions and (4) the extent and substantiality of the sales income with respect to the rental income earned by the taxpayer. *Cohn v. Commissioner*, *supra*; *Victory Housing No. 2 v. Commissioner*, 205 F. 2d 371 (C.A. 10th); *Mauldin v. Commissioner*, 195 F. 2d 714 (C.A. 10th). And, we submit, the Tax Court considered all of the aforementioned

criteria in arriving at its decision in the cases at bar.

In the cases under consideration the purpose for which the 85 houses were originally planned was for rent or sale to Hanford employees. (R. 16, 61.) However, such purpose was frustrated before the operation really began for the Hanford employees, who were to buy or rent the houses, were transferred to another part of the country. (R. 16.) While the foregoing stated purpose standing alone is inconclusive when considered along with taxpayer's subsequent conduct in disposing of the houses as fast as legally possible, it reveals that the houses were actually built for sale.² This conclusion, we submit, is inescapable when one considers, as did the lower court, the fact that although the construction of the houses was not finished until the spring of 1945, taxpayer sold as many of them as was permitted by the F.H.A. restrictions in that year, and, then when the sales restrictions were removed in 1946, disposed of all but one house which was occupied by taxpayer's assistant Mr. Beckwith, who was in charge of the Sunnyside project. (R. 17-18, 23, 84.) Indeed, the foregoing evidence completely negates any idea that the houses were erected as long range investment property and buttresses the position that the rental of the houses was merely incidental to their sale.³

² Taxpayer testified (R. 71-72) that one house was tentatively sold in 1944 before the project was completed but that he was told by the Hanford people that this was wrong and the sale did not go through. Taxpayer also testified that he applied some rental payments to the purchase price of the homes. (R. 23-24.)

³ This Court said in *Rollingwood Corp. v. Commissioner*, *supra* (p. 266):

Suppose the taxpayer in the instant case intended to rent the houses for as long as he was required to do so under existing regulations and then to sell them. Or suppose his in-

As we have already pointed out the Tax Court's decision is fully supported both by the frequency and continuity of sales and the extent and substantiality of the sales transactions. For the houses in question were sold as fast as possible under the existing F.H.A. restrictions; 84 of the 85 houses were disposed of within 18 months and the project manager's residence soon thereafter.

Courts have sometimes given consideration to the existence or absence of an advertising campaign being carried on by the taxpayer. In *Rollingwood v. Commissioner, supra*, where there was no advertising and no "for sale" signs used, this Court said (p. 267):

Petitioners insist that the sales were passive in that there were no "for sale" signs and no sales force. But the number of sales speak for themselves.

Here taxpayer testified (R. 65) that so many people tried to buy the houses that he could have sold them a dozen times over. He also said (R. 106) that "The houses were selling faster than we could get the renters out." As the Tax Court pointed out (R. 24) such a "considerable, continuous, and constant operation of sales was envisaged" that the assistant employed by the taxpayer was willing to accept a commission of only 2½ percent instead of the usual 5 percent.

tention was to pursue whichever of these activities proved to be the most profitable, that is, if the *rental market* were good he would continue to rent but if the *sales market* were high he would sell. In either of these suppositions we think it is fair to say that one of the essential purposes (in acquiring or holding the houses) is the purpose of sale. Under such circumstances, if the taxpayer does dispose of the houses by sale, is it within the legislative *purpose* to allow them to treat the proceeds of these sales as a capital gain? We think not.

As we have seen, taxpayer's transactions were not only substantial in number but also from the standpoint of financial return. Although it is true that the "disparity between income from sales and from rentals is not controlling" (*Delsing v. United States*, 186 F. 2d 59, 61 (C. A. 5th), see *Cohn v. Commissioner*, *supra*), ordinarily a taxpayer whose primary interest in real estate is investment income, or rentals, would be expected to receive more income from rentals than from sales.

In the case at bar, the taxpayer received the following profits from sales and rentals (R. 21-22):

Year	Profit from Sales	Net Rentals
1945	\$10,306.43	\$ 4,892.85
1946	20,050.98	(-) 1,034.25
1947 ⁴		

In 1945 and 1946, the taxpayer received \$3,858.60 net rental income from the 85 houses. Taxpayer realized a profit of \$30,357.41 from the sale of 84 of such houses. The ratio of profit from sales to total rental income from the houses is in excess of ten to one. The overwhelming ratio of sales income to rental income received by taxpayer from the houses shows quite conclusively that the houses were held *primarily* for sale to customers in the ordinary course of taxpayer's business and that their rental was only incidental thereto.

Taxpayer, however, in an obvious attempt to lift himself by his own bootstraps bases his argument on the contention (1) that during the taxable year involved here he was not only a general contractor but was also

⁴ The one house sold in 1947 was occupied by taxpayer's assistant (R. 18) so no rent was received and there is nothing in the record that would show the profit arising upon its sale.

in the business of renting real property (Br. 12, 17), and (2) that the sale of the 68 houses in question was not voluntarily made but rather was necessitated by his creditor's demand that he liquidate his indebtedness. (R. 13.)

1. It is of course possible to be engaged in the conduct of more than one business (*Fackler v. Commissioner*, 133 F. 2d 509 (C. A. 6th)) and each case in the end must be judged on its own facts. Indeed, as this Court pointed out in the *Rollingwood* case, *supra* (p. 266), most cases dealing with the problem of whether property was held primarily for sale to customers in the ordinary course of a taxpayer's trade or business involve a situation where such taxpayer is engaged in some activity apart from his usual occupation and the question is whether that activity constitutes a business. The fact that taxpayer was in the contracting business (R. 15) is not inimical to the further fact that he was also in the business of building 85 houses and holding them for sale. He treated this project as any other building would do, i.e., after finishing the development he sold the houses as fast as permitted by the applicable F. H. A. restrictions; none of the homes were retained for rental once the applicable selling restrictions had expired. (R. 17-18, 23.) The critical question is whether the 68 houses here involved were held *primarily* for sale to customers in the ordinary course of the business taxpayer was then carrying on. And this question the Tax Court has resolved against him on the basis of substantial evidence. The fact that the houses involved were at one time temporarily rented on a month to month basis is of no consequence. Cf. *Rollingwood Corp. v. Commissioner*, *supra* (p. 266).

Moreover, the fact that taxpayer is presently renting space in a building in Olympia (R. 19-20) has no relevancy here (Br. 17). The record discloses (R. 19-20) that the building taxpayer erected for Midfield Packers was contracted for in the ordinary course of his business as a general contractor and that he only acquired title to that property on September 9, 1949, and finished its construction to protect his original investment. Thus, the fact that taxpayer subsequently rented the aforementioned premises should have no bearing on the instant case.

2. There is no merit whatsoever to taxpayer's argument (Br. 12-13, 14) that he was forced by creditors to sell the 68 houses. This is evidenced not only by a lack of any substantiating data in the underlying record but also by taxpayer's own testimony about which the Tax Court observed (R. 23, fn. 1):

Petitioner testified that his working capital was frozen in the fall of 1945 and that he could not obtain further bank credit. In spite of this he makes much of the fact that throughout the year 1946 his salable assets upon which all selling restrictions had been removed were not in any way being pressed as a source of capital funds. We find it so difficult to reconcile these two statements that we have omitted any finding of fact based upon them.

Inasmuch as the issue here is a factual one and each case of this type must be decided on its own peculiar set of facts, it is not believed necessary or helpful to consider all the cases cited by the taxpayer. *Cohn v. Commissioner, supra*. However, we do note that taxpayer's reliance upon the decisions of this Court in the

McGah cases, *supra*; *Goldberg v. Commissioner*, 223 F. 2d 709 (C. A. 5th); and *Victory Housing No. 2 v. Commissioner*, *supra*, is misplaced due to obvious factual differences. The *McGah* cases are distinguishable from the instant proceeding in that (1) there from the very inception of the partnership business the idea of constructing houses for rental purposes was the dominating and controlling motive; and (2) there the decision to sell the rental units was not voluntarily made but rather was the result of a bank's demand for payment of part of the money owed it by the taxpayer.

In *Goldberg v. Commissioner*, *supra*, it is of primary importance to note that the Tax Court found as a fact and the Court of Appeals agreed that the taxpayer bought the property for rental as residential property, and further that while the lower court thought that the nature of taxpayer's business later changed to selling houses the Fifth Circuit decided that the facts of record merely indicated a liquidation of capital. Also the fact that the taxpayer in *Goldberg* was in the rental business for four years before liquidating serves to distinguish that case from the instant one where taxpayer sold all the houses as soon as possible.

In the *Victory Housing* case, the taxpayer was not engaged in the business of constructing units for sale to customers as here, but rather from its very formation was in the housing rental business. Furthermore the taxpayer there retained some of the houses for rental after the sales restrictions expired thus giving a basis for the court's holding that it merely liquidated a portion of its capital assets which did not constitute a sale of property in the ordinary course of business.

As we have previously said, the question of whether or not property was held primarily for sale to customers in the ordinary course of taxpayer's business is a question of ultimate fact, each case being required in the last analysis to turn on its own peculiar facts. Furthermore, here it is not a question of whether one case can be distinguished from another but rather whether there is substantial evidence to support the Tax Court's finding that taxpayer held the 68 houses in question primarily for sale to customers in the ordinary course of his business.

Under the circumstances, it is clear that the Tax Court has not erred in this case. It considered the crucial question as being whether at the time of sale the taxpayer held the 68 houses involved *primarily* for sale to customers in the ordinary course of his trade or business within the meaning of Section 117(a) and (j) of the 1939 Code. Considering the attending facts and circumstances, the Tax Court was amply justified in finding that the taxpayer so held the houses and, accordingly, in deciding that the gain realized on their sale was taxable as ordinary income rather than as long-term capital gain.

II

The Tax Court Erred When It Decided that Taxpayer's Basis for the 68 Houses in Question Should Not be Reduced by Allowable Depreciation

Section 23(1) of the Internal Revenue Code of 1939 (Appendix, *infra*) provides for a deduction on account of the depreciation of property by stating that a taxpayer in computing net income may deduct from gross income a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business *or held*

for the production of income.⁵ Section 111 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 111) provides that in computing gain or loss from the sale or disposition of property the resulting gain or loss shall be the excess of the amount realized over the adjusted basis provided in Section 113 (b) of the 1939 Code (Appendix, *infra*). Section 113 (b)(1)(B) of the 1939 Code (Appendix, *infra*) provides that, in arriving at the adjusted basis of property, taxpayer shall make an adjustment for depreciation to the extent allowed but not less than the amount allowable. *Virginian Hotel Co. v. Helvering*, 319 U. S. 523, 525, rehearing denied, 320 U. S. 810; *Blackhawk-Perry Corp. v. Commissioner*, 182 F. 2d 319, 321 (C. A. 8th).

In spite of the foregoing sections of the 1939 Code, the Tax Court rejected the Commissioner's contention that the taxpayer's basis for the 68 houses should be reduced on account of depreciation by holding (R. 25)—

respondent erred in reducing petitioner's basis on account of depreciation "allowable." Since we have concluded that from the inception petitioner held the property primarily for sale it would not qualify for the "use in trade or business" requirement of the depreciation deduction.

We, however, submit that, despite the aforementioned holding of the Tax Court, it is very clear that not only were the 68 dwellings held *primarily* for sale

⁵ It is important to note that the 68 houses here in question were exhaustible assets and therefore subject to depreciation under the income tax laws. *United States v. Koshland*, 208 F. 2d 636, 639-640 (C.A. 9th); *Commissioner v. Moore*, 207 F. 2d 265, 277 (C.A. 9th), certiorari denied, 347 U.S. 942.

to customers but also that up until the time of their disposal they were held "for the production of income" (rentals) and thus fall within the ambit of Section 23 (1) (2) of the 1939 Code (Appendix, *infra*), and should have been depreciated. Indeed, this Court in *Rollingwood v. Commissioner*, *supra* (pp. 265-266), stated that the fact of rental is not incompatible with a primary purpose of sale. See also *Palm Homes, Inc. v. Commissioner*, decided January 17, 1952 (1952 P-H T. C. Memo. Dec., par. 52,008).

It has consistently been the practice of the Commissioner to allow depreciation where, as here, property has been rented even though the renting was essentially temporary and the property was held primarily for sale to customers in the ordinary course of a taxpayer's business. *Rubino v. Commissioner*, decided December 28, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,288) affirmed, *per curiam*, 186 F. 2d 304 (C.A. 9th), certiorari denied, 342 U.S. 614; *A. L. Carter Co. v. Commissioner*, 143 F. 2d 296, 297-298 (C. A. 5th); *Black v. Commissioner*, 45 B.T.A. 204. Therefore, we submit that the Tax Court clearly erred when it refused to require the taxpayer to reduce the basis of the houses sold in 1946 by the allowable depreciation.

III

The Tax Court Erred in Holding that the Proceeds Received by the Taxpayer from the Sale of Furnaces, Refrigerators and Ranges for Salvage Were Taxable as Capital Gain Rather Than as Ordinary Income

Taxpayer equipped the 85 houses constructed in Sunnyside, Washington with furnaces, refrigerators and ranges. The furnaces however proved defective and so were removed and replaced by taxpayer with oil furnaces; the old furnaces were scrapped and taxpayer realized \$650 from the sale of their usable parts. Some of the tenants and purchasers of taxpayer's houses owned their own ranges and refrigerators and did not desire to purchase or rent a house unless these items were removed. Taxpayer complied with their wishes and removed the unwanted ranges and refrigerators which he sold as second hand for \$6,218.88. (R. 22, 54-56, 90-91.) The record, outside of taxpayer's self-serving declarations (R. 55-56) does not reveal that any adjustments were ever made to the cost basis of the houses and the receipts garnered from the sale of the furnaces, ranges and refrigerators in 1946 were never closed to profit or loss. Therefore, the Commissioner treated those omitted receipts as additional ordinary income for 1946.⁶

The Tax Court however found (R. 22) that the taxpayer was never in the business of selling second-hand furnaces, ranges or refrigerators and held (R. 26):

In placing some of the properties in proper condition it apparently became necessary for peti-

⁶ It can safely be assumed that pursuant to usual business practices the original cost of the furnaces, ranges and refrigerators was treated as a part of the construction cost of the homes with taxpayer receiving credit for them when he charged off the allocated building costs on his returns for 1945, 1946, and 1947. (R. 55.)

tioner to remove some furnaces, ranges and refrigerators. These were subsequently sold for their salvage value and respondent insists that this income also is ordinary income and not capital gain. We are unable to agree.

Whatever petitioner's business as builder, developer and seller of finished houses, he was not in the business of selling used or secondhand equipment. These items were not held for sale in the ordinary course of petitioner's business.

Section 117 (a) of the 1939 Code defines capital assets to mean "property held by the taxpayer (whether or not connected with his trade or business) * * *." Standing alone, this broad definition would also include property purchased for the purpose of resale. But the statute limits the breadth of the definition by excluding certain classes of property from being considered as capital assets among which are: (1) Stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year; (2) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; and (3) property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (1), or real property used in his trade or business, and which falls in classes (1) and (2).

In view of the Tax Court's finding (R. 22) that the houses erected by taxpayer in Sunnyside were held primarily for sale in the ordinary course of his business it is submitted that the furnaces, refrigerators and ranges, initially being an integral part of the houses, were unquestionably purchased and held for sale. And

it also seems clear that the disposal of the furnaces, refrigerators and ranges did not constitute a new business but was merely an adjunct of the business of selling the houses. Cf. *Nuta v. Commissioner*, decided September 24, 1952 (1952 P-H T.C. Memorandum Decisions, par. 52,283). Indeed the present situation is analogous to that faced daily by department stores which sell defective material or returned merchandise at reduced prices—the gain or loss from such sales being treated as ordinary income. Therefore, the furnaces, refrigerators and ranges were in all essential respects a part of taxpayer's stock in trade held for sale and the gain realized by taxpayer on their sale should be taxable as ordinary income rather than as capital gain.

In essence, this has been the view taken by this Court. In *Fidler v. Commissioner*, decided March 1, 1955 (1955 C.C.H., par. 9263), the taxpayer was required to treat the loss sustained on the sale of certain literary properties owned by him as a capital loss rather than as an ordinary loss on the basis that (1) he did not purchase the properties for use in his business; (2) he made an investment in the literary properties with the hope of selling them at a profit; and (3) he did not hold them primarily for sale to customers in the ordinary course of his trade or business or show that they constituted stock in trade or property of a kind which would properly be included in inventory. Here, using the very same reasoning, it is readily apparent that taxpayer purchased the property in question for use in his business, always expected to realize a profit from their sale and held them prior to their removal primarily for sale to customers in the ordinary course

of his trade or business as an integral part of the houses. Moreover, after their removal he did not modify his intention to dispose of them. This is conclusively shown in the fact he did actually sell them as salvage.

In *Grace Bros. v. Commissioner*, 173 F. 2d 170, this Court held (pp. 178-179) that taxpayer's liquidation of stock in trade did not convert it into a capital asset. And in *Commissioner v. Boeing*, 106 F. 2d 305 (C.A. 9th), certiorari denied, 308 U.S. 619, it was held immaterial that a taxpayer, engaged in the sale of cut logs from lands owned by him, was motivated by a desire to liquidate his investment. The gain resulting from such sales—being from his “trade or business”—was ruled ordinary income.

Since the furnaces, refrigerators and ranges sold by the taxpayer in the instant case were held primarily for sale to customers as a part of his business of disposing of the houses they are clearly denied treatment as capital assets by Section 117(a) of the 1939 Code, and the gain resulting from their sale must be considered ordinary income. *Richards v. Commissioner*, 81 F. 2d 369, 373 (C.A. 9th).

CONCLUSION

We submit that the decision of the Tax Court, in so far as it held that the 68 houses were held primarily for sale to customers in the ordinary course of taxpayer's business is correct and should be affirmed by this Court. On the other hand, we submit that that portion of the lower court's decision holding (1) that taxpayer's basis for the 68 houses should not be reduced for allowable depreciation; and (2) that the receipts from the sale of the furnaces, ranges and refrigerators

should be treated as capital gain is clearly erroneous and should be reversed by this Court.

Respectfully submitted,

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NOVEMBER, 1955

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(1) [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121 (c)] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction

shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * *

(b) [as amended by Sec. 130 (b), Revenue Act of 1942, *supra*; Sec. 204 (b), Revenue Act of 1950, c. 994, 64 Stat. 906; and Sec. 1, Act of July 14, 1952, c. 741, 66 Stat. 629] *Adjusted Basis*.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule*.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made for taxes or other carrying charges, or for expenditures described in section 23 (bb), for which deduc-

tions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

(i) allowed as deductions in computing net income under this chapter or prior income tax laws, and

(ii) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this chapter (other than subchapter E), subchapter E of chapter 2, or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this chapter or prior income tax laws. Clause (ii) of this subparagraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1952, unless an election has been made under subsection (d). Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(C) in respect of any period prior to March 1, 1913, for exhaustion, wear and tear, obsoles-

cence, amortization, and depletion, to the extent sustained;

* * * * *

(26 U.S.C. 1952 ed., Sec. 113.)

SEC 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions*.—As used in this chapter—

(1) *Capital assets*.—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1);

* * * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, *supra*, and amended by Sec. 127 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business*.—

(1) *Definition of property used in the trade or business*.—For the purposes of this subsection, the term “property used in the trade or business” means property used in the trade or

business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23(1)-1. *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the

salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. * * *

Sec. 29.117-1. *Meaning of Terms.*—The term “capital assets” includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a “capital asset,” the period for which held is immaterial.

The exclusion from the term “capital assets” of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23(1) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117(b) and losses from such transactions are not subject to the limitations on losses provided in section 117(d), except that under section 117(j) the gains and losses from the sale or exchange of such property held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See sections 29.117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term “capital assets” even though depreciation may have been allowed with respect to such property under section 23(1) prior to its amendment by the Reve-

nue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117(b), (c), and (d). The term "ordinary net income" as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

* * * * *

No. 14737

In the United States Court of Appeals
for the Ninth Circuit

A. G. HOMANN, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ANNA HOMANN, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

A. G. HOMANN, *Respondent*

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

ANNA HOMANN, *Respondent*

ON PETITIONS FOR REVIEW OF THE DECISIONS
OF THE TAX COURT OF THE UNITED STATES

TAXPAYERS' REPLY BRIEF

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FILE

DEC 13 195

PAUL P. O'BRIEN,

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In the United States Court of Appeals for the Ninth Circuit

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COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

ANNA HOMANN, *Respondent*

ON PETITIONS FOR REVIEW OF THE DECISIONS
OF THE TAX COURT OF THE UNITED STATES

TAXPAYERS' REPLY BRIEF

SUMMARY OF ARGUMENT

I

In the taxpayers' opening brief it is urged that the Tax Court erred in the determination that the 68 houses sold in the year 1946 were held for sale to customers in the

ordinary course of business and the gain resulting was taxable as ordinary income. For the reasons urged in the opening brief, taxpayers urged that the Tax Court erred in this respect.

II

In the Commissioner's petition for review, reversal is sought of the Tax Court's finding that the taxpayers' basis for the 68 houses should be reduced by depreciation. In the Tax Court the Commissioner conceded that if the houses were held by the taxpayers for sale in the ordinary course of business that the tax basis should not be reduced by allowable depreciation. This question was not argued by the taxpayers in the Tax Court and the Tax Court's finding in this respect was invited by the Commissioner and cannot now be argued as grounds for reversal.

III

Commissioner's petition also asserts error in the Tax Court's finding that the sale of salvage material removed from the houses resulted in ordinary income.

Taxpayers maintain, however, that the Tax Court correctly held the proceeds from the salvage sale of the equipment removed from the houses resulted in capital gain and not ordinary income because taxpayers were never in the business of selling such salvage material.

ARGUMENT

The Gain Realized by the Taxpayers on the Sale of 68 Houses and Lots in the Calendar Year 1946 Is Taxable as Capital Gain under Section 117 of the Internal Revenue Code of 1939.

The Commissioner relies upon *Rollingwood v. Commissioner*, 190 F. 2d 263 (9th Cir.), but factually the relationship with the instant case is remote indeed. Bohannon, the principal in the *Rollingwood* case, had a controlling stock interest in the Rollingwood Corporation, and the Court of Appeals pointed out that Bohannon's business before the outbreak of the war was that of constructing homes, subdividing and selling real property. The sale of the Rollingwood houses was not to preserve a rental investment but to continue in the business of building homes for sale.

While Homann never before or since built houses for his own account or for sale to others, the important thing is that his purpose in building the houses was to obtain a rental investment which was thwarted by circumstances beyond his control. In consequence of which he was obliged to liquidate his investment in the Sunnyside houses in order to save the Olympia building which has proved a desirable rental investment and which he still has.

The 7th Circuit decided *Chandler v. U. S.* on October

14, 1955 (1955 C.C.H. par. 9691) in which the conclusion was reached in harmony with the cases cited by taxpayers that the question whether the property was held primarily for sale to customers is a conclusion of law or a mixed question of law and fact. It was further held that in a desire to liquidate an unprofitable holding of a million acres, the fact that the taxpayer made many separate sales, was not significant.

II

The Tax Court Correctly Held That if the Houses Were Held Primarily for Sale that the Taxpayers' Basis Should Not Be Reduced By Allowable Depreciation.

The Commissioner's brief (P. 21) quotes a portion of the finding of the Tax Court on the question of depreciation (R. 25) but significantly omits the all important concluding sentence. The complete finding is as follows:

“By the same token, however, respondent erred in reducing petitioner's basis on account of depreciation “allowable.” Since we have concluded that from the inception petitioner held the property primarily for sale it would not qualify for the “use in trade or business” requirement of the depreciation deducton. In fact, we do not read respondent's contentions as seriously opposing this view.” (P.25) (Underscoring supplied).

The Commissioner's contention is untenable for two reasons. First, if erroneous, it is invited error and second,

is was urged below.

This case was not argued orally in the Tax Court, but, after the testimony was completed, was submitted entirely upon written briefs. The section of the Commissioner's brief dealing with the question of depreciation is reprinted herein as "Appendix A."

The position taken by the Commissioner is significantly stated in this paragraph:

"The petitioner took no depreciation on the houses in the year 1945 or the year 1946. This, of course, is in full accord with respondent's theory of this case since if the the houses were held primarily for sale no depreciation could be taken. The statutory notice of deficiency has thereby reduced the basis by the amount of the depreciation allowed or allowable and this was done merely by way of protecting the revenues since, if the petitioner is sustained in his argument that the houses were property used in the trade or business, the depreciation should have been taken." (Underscoring supplied).

With this view the taxpayer agrees and consequently had no reason for discussing the question of depreciation in either the opening or reply briefs in the Tax Court.

It is readily conceded that if the ultimate decision is that the property was held for investment and not for sale to taxpayers' customers in the ordinary course of business, that the allowable depreciation must be taken into account in determining the gain. On the other hand, if the Tax

Court's conclusion is correct that the houses were held for sale to the taxpayers' customers in the ordinary course of business, then that is the very antithesis of the finding that the houses were held for the production of income and depreciation cannot be taken into account in determining the gain. That is the gist of the Tax Court's decision and the Commissioner in his brief categorically stated that if the houses were held primarily for sale no depreciation could be taken and consequently in the concluding sentence of the finding, the Tax Court observed:

“In fact, we do not read respondent's contentions as seriously opposing this view.”

The Commissioner may not take one position in the Tax Court and then urge on review here a completely antagonistic theory. This Court said in *U. S. v. Waechter*, 195 F. 2d 963:

“We agree that the Government, whatever may be the strength of its present argument, cannot fairly urge as a ground for reversal a theory which it did not present while the case was before the trial court.”

See also *Inman-Paulsen Lumber Company v. C. I. R.*, 219 F. 2d 159.

Moreover, if erroneous, the error was invited and invited error is not ground for reversal, *Capella v. Zurich General Accident Liability Insurance Company*, 194 F.

2d 588; *Orenstein v. U. S.*, 191 F. 2d 181; *Smails v. O'Malley*, 127 F. 2d 410; *Reidy v. Myntti*, 116 F. 2d 725.

A party, including the United States, cannot urge error on a ruling or judgment made with express or implied consent, *United States v. Star Construction Co.*, 186 F. 2d 666(C. A. 10th; 1951).

III

The Tax Court Correctly Found that the Proceeds from the Salvage Sale of Equipment Removed from the Houses Resulted in Capital Gain and Not Ordinary Income.

Proceeds from the salvage sale of furnaces, refrigerators and ranges removed from houses resulted in capital gain rather than ordinary income.

The houses upon completion were equipped with ranges and refrigerators. Some purchasers or tenants had their own ranges or refrigerators and did not desire to purchase others, in consequence of which such items were removed and sold for whatever salvage they would bring.

The original furnaces in the houses all proved defective and were removed after causing two hostile fires and replaced with suitable heating equipment. The defective furnaces were sold which resulted in some salvage. Upon the undisputed proof in this connection, the Tax Court made the following finding:

“In placing some of the properties in proper condition it apparently became necessary for petitioner to remove some furnaces, ranges and refrigerators. These were subsequently sold for their salvage value and respondent insists that this income also is ordinary income and not capital gain. We are unable to agree.

Whatever petitioner’s business as builder, developer and seller of finished houses, he was clearly not in the business of selling used or secondhand equipment. These items were not held for sale in the ordinary course of petitioners’ business.” (R. 26).

The taxpayers have never been engaged in the business of selling such salvage material either before or since. The Tax Court’s finding that the profit resulting from the sale of that salvage was a capital gain and taxable as such and not ordinary income should be affirmed.

CONCLUSION

Taxpayers respectfully submit that the Tax Court erred in determining that the 68 houses were held primarily for sale in the ordinary course of business and that consequently the gain resulting from the sale was taxable as ordinary income and not at the capital gains rate. If the Tax Court is reversed on the foregoing primary proposition, then the gain should be reduced by the “allowable” depreciation. On the other hand, if the Tax Court is affirmed on the primary question, then it should like-

wise be affirmed in its finding that the tax basis should not be reduced by depreciation. In any event, the Tax Court's conclusion that the taxpayers were never in the business of selling secondhand ranges, furnaces and refrigerators, is manifestly correct and its conclusion that the income resulting from such salvage sales is taxable at the capital gain rate should be affirmed.

Respectfully submitted,
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APPENDIX A

EXCERPT FROM THE COMMISSIONER'S BRIEF

Filed in the Tax Court, February 18, 1954

A. In the event it is held that the houses sold by petitioner in the year 1946 were not held primarily for sale in the ordinary course of petitioners' business then the basis of the houses sold must be reduced by the amount of the depreciation allowed or allowable. In any event, since the record shows that two houses were sold subsequent to the taxable year, the basis must be adjusted to eliminate that portion of the houses which remained unsold at the end of the taxable year.

The petitioner took no depreciation on the houses in the year 1945 or the year 1946. This, of course, is in full accord with respondent's theory of this case since if the houses were held primarily for sale no depreciation could be taken. The statutory notice of deficiency has thereby reduced the basis by the amount of the depreciation allowed or allowable and this was done merely by way of protecting the revenues since, if the petitioner is sustained in his argument that the houses were property used in the trade or business, the depreciation should have been taken.

Before discussing the case law with regard to this particular point it is hereby pointed out that the Court's holding on the major issue in this case could influence the decision on this issue in still another way. If, for example, the Court should hold that the houses were held primarily for sale—starting in 1946—then the respondent should be sustained on the depreciation issue as to 1946 and the basis should be reduced accordingly. The respondent has contended in the major argument that the houses were either always held for sale or that the purpose in holding the houses changed so that in any event they were held for sale at the time of their disposal.

Section 23(1) of the Internal Revenue Code provides for the deduction of depreciation by saying that the

taxpayer may deduct from gross income in arriving at net income a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business. Section 111 of the Internal Revenue Code provides that in computing gain or loss the gain or loss shall be the excess of the amount realized over the adjusted basis provided in section 113 (b) of the Internal Revenue Code. Section 113—which contains the basis provisions—first provides under subsection (a) that the unadjusted basis shall be cost. Under subsection (b) the adjustments are made which result in the adjusted basis which is what we are here concerned with. Section 113 (b) (1) (B) provides that in arriving at adjusted basis the taxpayer shall make an adjustment for depreciation to the extent allowed but not less than the amount allowable. The reason for this is obvious. It precludes the taxpayer from taking advantage in a later year of his prior failure to take any depreciation allowance. See Regulations 29.23(1)-5.

Under the authority of *Virginian Hotel Corporation v. Helvering* (1943) 319 U. S. 523 /30 A.F.T.R. 1304/, if the property in the instant case is held by this Court to be property used in the trade or business either in 1945, 1946 or both years then the respondent's action in reducing the basis by this amount must be sustained at least as to the year in which the property was so held.



